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# 1983–84 MISCELLANEOUS TAX BILLS—IX: S. 146, S. 1332, S. 1768, S. 1809, AND S. 2080

## HEARING

BEFORE THE

SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

OF THE

## COMMITTEE ON FINANCE
## UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

ON

## S. 146, S. 1332, S. 1768, S. 1809, AND S. 2080

MARCH 16, 1984

Printed for the use of the Committee on Finance

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# 1983-84 MISCELLANEOUS TAX BILLS: S. 146, S. 1332, S. 1768, S. 1809 and S. 2080

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**FRIDAY, MARCH 16, 1984**

COMMITTEE ON FINANCE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 9:30 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Bob Packwood (chairman) presiding.

Present: Senator Packwood.

Also present: Senator George Mitchell, Senator William S. Cohen.

[The press release announcing the hearing and background material on the five miscellaneous tax bills by the Joint Committee on Taxation, and the prepared statement of Senator Baucus follow:]

[Press Release No. 84-121, Feb. 24, 1984]

FINANCE SUBCOMMITTEE SETS HEARING ON MISCELLANEOUS TAX BILLS

Senator Bob Packwood, Chairman of the Subcommittee on Taxation and Debt Management of the Committee on Finance, announced today that a hearing will be held on five miscellaneous tax bills.

The hearing will be held on Friday, March 16, 1984, at 9:30 a.m. in Room SD-215 of the Dirksen Senate Office Building.

The following proposals will be considered:

*S. 146.*—Introduced by Senator Mitchell for himself and others. S. 146 would exempt certain fishing vessels from Federal Unemployment Tax.

*S. 1332.*—Introduced by Senator Mitchell. S. 1332 would increase the amount of investment credit to 10 percent which may be claimed on Capital Construction Fund withdrawals.

*S. 1768.*—Introduced by Senator Mitchell. S. 1768 would provide energy tax credits for equipment used aboard or installed on fishing vessels.

*S. 1809.*—Introduced by Senator Baucus. S. 1809 would disregard the attribution between limited partners of stock of a publicly owned investment company for the purpose of determining whether that company is a personal holding company or a regulated investment company.

*S. 2080.*—Introduced by Senator Packwood. S. 2080 would make permanent a provision to encourage employers to provide legal services for their employees.

# DESCRIPTION OF TAX BILLS
## (S. 146, S. 1332, S. 1768, S. 1809, and S. 2080)

SCHEDULED FOR A HEARING

BEFORE THE

## SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

## COMMITTEE ON FINANCE

ON MARCH 16, 1984

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Prepared by the Staff

OF THE

## JOINT COMMITTEE ON TAXATION

### INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on March 16, 1984, before the Senate Finance Subcommittee on Taxation and Debt Management.

The five bills scheduled for the hearing are S. 146 (permanent exemption from FUTA tax for wages of certain fishing boat crew members); S. 1332 (relating to investment tax credit for certain vessels acquired with funds withdrawn from a capital construction fund); S. 1768 (energy tax credit for certain fishing vessel equipment); S. 1809 (exception for regulated investment companies from definition of personal holding company); and S. 2080 (permanent exclusion for benefits under group legal services plans).

The first part of the pamphlet is a summary of the bills. This is followed in the second part by a more detailed description of the bills, including present law, explanation of provisions, and effective dates.

# I. SUMMARY

## 1. S. 146—Senators Mitchell, Cohen, Mathias, Heflin, and Sarbanes

### Permanent Exemption from FUTA Tax for Wages of Certain Fishing Boat Crew Members

Prior to the Economic Recovery Tax Act of 1981, the remuneration paid to fishing boat crew members who were considered self-employed for social security tax purposes, and whose remuneration was exempt for purposes of the tax imposed by the Federal Insurance Contributions Act (FICA) and for purposes of income tax withholding, was not exempt from tax under the Federal Unemployment Tax Act (FUTA) if the services performed were related to catching halibut or salmon for commercial purposes or if the services were performed on a vessel of more than ten net tons.

The Economic Recovery Tax Act of 1981, as amended by the Miscellaneous Revenue Act of 1982, amended the definition of employment for purposes of FUTA taxes to exempt from FUTA taxes remuneration paid during 1981 and 1982 to fishing boat crew members who were treated as self-employed for purposes of social security taxes.

The bill would have the effect of making permanent this exemption from FUTA taxes for taxable years beginning after 1982.

## 2. S. 1332—Senator Mitchell

### Investment Tax Credit for Certain Vessels Acquired With Funds Withdrawn from a Capital Construction Fund

Present law provides that taxable income is reduced by amounts equal to certain amounts deposited in a capital construction fund established under section 21 of the Merchant Marine Act of 1970 (46 U.S.C. 1177(d)). When withdrawn from the fund, such amounts are generally taxable unless used to acquire, construct, or reconstruct a qualified vessel. If used to acquire, construct, or reconstruct a qualified vessel, such amounts are not taxable; however, the taxpayer's basis in the vessel is reduced to reflect the fact that the taxpayer had previously deducted those amounts.

Present law also generally provides that the amount of investment tax credit allowable with respect to new property eligible for the credit is determined with reference to the basis in such property. For investment credit purposes, the basis of a qualified vessel financed in whole or in part with previously deducted funds withdrawn from a capital construction fund is not to be reduced by more than 50 percent of the amount of previously deducted funds so withdrawn (Code sec. 46(g)).

The bill would provide that for investment credit purposes, the basis of a qualified vessel financed in whole or in part with previously deducted funds withdrawn from a capital construction fund is not to be reduced by any portion of the previously deducted funds so withdrawn. Thus, no investment credit otherwise available would be lost. The bill would be effective for taxable years beginning after 1982.[1]

### 3. S. 1768—Senator Mitchell

### Energy Tax Credit for Certain Fishing Vessel Equipment

In general, the 10-percent business energy investment tax credit expired after 1982. However, the general 10-percent energy credit for certain types of long-term energy projects continues through 1990 if certain affirmative commitments were made in connection with the projects. Also, certain business energy credits (other than the general 10-percent energy credit), such as the 15-percent credit for solar, wind, or geothermal property and the 10-percent credit for biomass property, continue through 1985.

Under the bill, a 10-percent energy tax credit would be provided for 11 specified items of equipment used aboard or installed in fishing vessels. The credit would apply for equipment placed in service in 1983, 1984, and 1985.

### 4. S. 1809—Senator Baucus

### Exception for Regulated Investment Companies from Definition of Personal Holding Company

Under present law, a corporation is treated as a personal holding company if, among other requirements, at any time during the last half of the taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by or for no more than five individuals (Code secs. 541-547). For this purpose, an individual is considered as owning the stock owned, directly or indirectly, by or for members of his or her family, or by or for a partner of the individual. A personal holding company cannot qualify as a regulated investment company.

Under the bill, an investment company would not be treated as a personal holding company if certain stock ownership tests are met. Further, for purposes of applying such tests, stock owned, directly or indirectly, by or for an individual would not be attributed to such individual's partners in a limited partnership. The amendments made by the bill would apply to taxable years ending on or after the date of enactment.

### 5. S. 2080—Senators Packwood, Moynihan, and Stevens

### Permanent Exclusion for Benefits Under Group Legal Services Plans

Under present law, amounts contributed by an employer to a qualified group legal services plan for employees (or their spouses

[1] It is understood that this date would be changed to December 31, 1983.

or dependents) are excluded from an employee's gross income for income tax purposes (Code sec. 120) and from wages for employment tax purposes (secs. 3121(a)(17), 3306(b)(12)). Present law also provides that an organization created exclusively to form part of a qualified group legal services plan may be exempt from income tax (sec. 501(c)(20)). The exclusion for prepaid legal services and the tax exemption for group legal services organizations are scheduled to expire for taxable years beginning after December 31, 1984.

The bill would make permanent the exclusion from gross income for payments to or under a qualified group legal services plan and the tax-exempt status of group legal services organizations. The bill would be effective on the date of enactment.

## II. DESCRIPTION OF THE BILLS

### 1. S. 146—Senators Mitchell, Cohen, Mathias, Heflin, and Sarbanes

### Permanent Exemption from FUTA for Wages of Certain Fishing Boat Crew Members

#### *Present Law*

For purposes of social security taxes and income tax withholding, members of the crew on a boat in a fishing operation engaged in catching fish or other forms of aquatic animal life are considered to be self-employed if (1) their remuneration is a share of the boat's catch (or cash proceeds from the sale of a share of the catch and no other cash remuneration is provided), (2) their share depends on the amount of the boat's catch, and (3) if the crew of the boat normally is made up of fewer than ten individuals. If these requirements are met, remuneration paid to these crew members is exempt from the Federal Insurance Contributions Act (FICA) tax and income tax withholding, and is subject to the Self-Employment Contributions Act (SECA) tax (Code secs. 3121(b)(20), 3401(a)(17), and 1402(c)(2)(F)).

Prior to the Economic Recovery Tax Act of 1981 (ERTA), remuneration paid to fishing boat crew members was not exempt from tax under the Federal Unemployment Tax Act (FUTA) if the services performed were related to catching halibut or salmon for commercial purposes or if the services were performed on a vessel of more than ten net tons (sec. 3306(c)(17)).

Section 822 of ERTA amended the definition of employment for purposes of FUTA taxes to exempt from FUTA taxes remuneration paid during 1981 to fishing boat crew members who were treated as self-employed for social security tax purposes and thus exempt from FICA. The exemption from FUTA taxes was limited to 1981 to give the Congress an opportunity (1) to determine the best long-term solution to the problem of fishing boat crew members who are treated as self-employed for purposes of social security and income tax withholding, but who are not treated as self-employed for purposes of the unemployment tax provisions, and (2) to make certain that no fishing boat crew members would be adversely affected. Section 203 of the Miscellaneous Revenue Act of 1982 (P.L. 97-362) amended ERTA to provide that the exemption from FUTA taxes was effective for remuneration paid in 1981 and 1982.

#### *Explanation of the Bill*

The bill would provide that, notwithstanding any other provisions of law, the definition of employment and the exclusions from that definition for purposes of FUTA, as amended by section 822 of

ERTA and section 203 of the Miscellaneous Revenue Act of 1982, are effective with respect to taxable years beginning after 1982. Thus, the bill would make permanent the present FUTA tax exemption for remuneration paid to fishing boat crew members who are treated as self-employed and are exempt from FICA.

***Effective Date***

The bill would be effective upon enactment.

## 2. S. 1332—Senator Mitchell

## Investment Tax Credit for Certain Vessels Acquired With Funds Withdrawn from a Capital Construction Fund

### *Present Law*

#### *The Merchant Marine Act of 1970*

The Merchant Marine Act of 1970, as amended (the "Act"), provides certain Federal income tax incentives for U.S. taxpayers owning or leasing vessels operating in the foreign or domestic commerce of the U.S. or in U.S. fisheries (46 U.S.C. sec. 1177(d)).

In general, such taxpayers are entitled to deduct from income certain amounts deposited in a capital construction fund pursuant to an agreement with the Secretary of Transportation or, in the case of U.S. fisheries, the Secretary of Commerce. Furthermore, earnings from the investment or reinvestment of amounts in such a fund are excluded from income. The purpose of the Act is to provide a tax inducement to aid the U.S. shipping and shipbuilding industries.

A nonqualified withdrawal of previously deducted or excluded monies by a taxpayer from a fund will generate income to the taxpayer. However, a qualified withdrawal will not. A qualified withdrawal is a withdrawal, made in accordance with the terms of the applicable agreement, which is for the acquisition, construction, or reconstruction of a qualified vessel or for the payment of principal on indebtedness incurred in connection with the acquisition, construction, or reconstruction of such a vessel. A qualified vessel is a vessel (including barges and containers which are part of the complement therefor) constructed or reconstructed in the U.S. and documented under U.S. laws which is to be operated in the U.S. foreign, Great Lakes, or noncontiguous domestic trade or in U.S. fisheries.

#### *Cost recovery*

Since the Act provides for the deduction (or exclusion) of certain amounts deposited in a capital construction fund and their tax-free withdrawal in the case of a qualified withdrawal, the Act also requires a reduction in the tax basis of the qualified vessel in an amount based on the amount of funds withdrawn. Without that rule, a taxpayer would be entitled to cost recovery deductions with respect to amounts the taxpayer had already deducted from (or never included in) income. The purpose of that rule, then, is to prevent double deductions.

#### *Investment tax credit*

In general, the amount of investment tax credit for eligible new property (new section 38 property) is determined with reference to

the basis of such property to the taxpayer (Code sec. 46(c)(1)(A)). Under Treasury regulations, if the basis of new section 38 property is reduced, for example, as a result of a refund of part of the cost of the property, then investment credit is recaptured (Treas. Reg. sec. 1.47-2(a)(1)).

Prior to 1976, the law made no explicit provision for the effect of the Act's basis reduction rules on the amount of investment credit to be allowed with respect to a qualified vessel constituting new section 38 property which was financed in whole or in part by qualified withdrawals from a capital construction fund. The Internal Revenue Service has ruled that the investment credit should be determined with reference to the property's basis after the reduction required by the Act (Rev. Rul. 67-395, 1967-2 C.B. 11).

Two courts have addressed the issue. The U.S. Tax Court has agreed with the Internal Revenue Service (*Zuanich* v. *Comm'r,* 77 T.C. 428 (1981)). However, the U.S. Court of Claims (now the Claims Court) has disagreed, holding on several occasions that the fact that the cost of a qualified vessel was financed in whole or in part by previously deducted or excluded funds withdrawn from a capital construction fund has no effect on the investment credit to be allowed (see, e.g., *Oglebay Norton Co.* v. *U.S.*, 79-2 USTC para. 9705 (1979); and *Pacific Far East Line, Inc.* v. *U.S.*, 76-2 USTC para. 9718 (1976)). Based on the foregoing, taxpayers facing the issue generally seek to litigate it in the Claims Court.

The Internal Revenue Service has also ruled that a qualified withdrawal of previously deducted or excluded funds used to pay a principal amount on mortgage indebtedness incurred to purchase a qualified vessel should be treated as reducing basis for investment credit purposes and triggering investment credit recapture under Treas. Reg. sec. 1.47-2(a)(1) (see, e.g., Rev. Rul. 68-468, 1968-2 C.B. 26).

The Tax Reform Act of 1976 provided, only for purposes of determining the investment credit, that basis is to be reduced by not more than 50 percent of the amount of a qualified withdrawal of previously deducted or excluded funds (sec. 46(g)). That rule was made applicable with respect to investment credits claimed in years beginning after 1975. However, section 46(g)(3) and its legislative history make it clear that the new rule established only a floor for, and not a ceiling on, the amount of basis which a qualified vessel would be treated as having for investment credit purposes. In other words, after the Tax Reform Act of 1976, a taxpayer could seek to establish that no investment credit should be lost merely because a qualified withdrawal of previously deducted or excluded funds had been used in financing the acquisition, construction, or reconstruction of a qualified vessel (see *Zuanich* v. *Comm'r, supra*).

The Tax Equity and Fiscal Responsibility Act of 1982 generally provided that for cost recovery purposes, the basis of property is to be reduced by 50 percent of any investment credit allowed (sec. 48(q)). An election to reduce allowable investment credit in lieu of reducing basis for cost recovery purposes is available. Present law is not explicit as to how this basis reduction rule applies in a case where a qualified vessel is financed by means of a qualified withdrawal of previously deducted or excluded funds, particularly if the vessel is financed entirely by means of such a withdrawal. In the

latter case, the vessel would have no basis for cost recovery purposes to reduce.

### *Issues*

The cost recovery and investment tax credit rules enacted in the Economic Recovery Tax Act of 1981 and the Tax Equity and Fiscal Responsibility Act of 1982 together provide tax benefits for investments in equity-financed depreciable personal property approximately the equivalent of current expensing of the cost of that property. Those rules include provisions which require that a taxpayer elect either to reduce the basis of property for cost recovery purposes by one-half the amount of investment credit taken or reduce the investment credit with respect to such property (sec. 48(q)).

Disregarding investment credits, the present-law rules applicable to certain deposits into a capital construction fund provide tax benefits in excess of those which would be allowed under a system permitting current expensing of that portion of the cost of a qualified vessel financed by means of a qualified withdrawal. That result occurs because funds ultimately to be used in acquiring, constructing, or reconstructing a qualified vessel, a depreciable asset, are deductible (or excludable) before the vessel is placed in service, perhaps even before any contract to acquire, construct, or reconstruct such a vessel is entered into. To the extent any investment credit is allowed with respect to a qualified withdrawal of previously deducted or excluded funds, the tax benefits increase. Finally, to the extent a full investment credit is allowed without any adjustment in basis for cost recovery purposes of the type provided for by section 48(q), the available tax benefits continue to improve.

On the other hand, the Congress over the years has evidenced a policy of providing tax incentives to the domestic shipping and shipbuilding industries. The Merchant Marine Acts and section 46(g) of the Tax Reform Act of 1976 illustrate the point. The bill would provide further support for those industries by codifying the line of cases from the Court of Claims permitting a full investment credit.

The principal issues are whether tax incentives for the domestic shipping and shipbuilding industries should be statutorily increased and, if so, by what amount.

### *Explanation of the Bill*

#### *Initial financing*

The bill would provide that no investment credit with respect to a qualified vessel is to be unavailable merely because all or part of the cost of the acquisition, construction, or reconstruction of such a vessel is financed by any deposit in or qualified withdrawal of previously deducted or excluded amounts from a capital construction fund under the Act (sec. 46(g)). Thus, the bill would overturn the holdings in Rev. Rul. 67-395 and *Zuanich* v. *Comm'r, supra*. The bill would make no special provision for adjusting basis for cost recovery purposes.

***Payment of principal amount on mortgage indebtedness***

The bill would also provide that using funds received in a qualified withdrawal of previously deducted or excluded amounts to pay down principal on indebtedness secured by a mortgage on a qualified vessel is not to give rise to any investment credit recapture.[1] Thus, the bill would also overturn the ruling in Rev. Rul. 68-468, *supra*.

***Effective Date***

The bill would be effective for taxable years beginning after December 31, 1982,[2] and to investment credits allowed for such taxable years.

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[1] Technical corrections would be needed to the references in the bill to section 167 and to actual useful life.

[2] It is understood that this date would be changed to December 31, 1983.

## 3. S. 1768—Senator Mitchell

## Energy Tax Credit for Certain Fishing Vessel Equipment

### *Present Law*

***General rules***

Prior to 1983, the law provided a general 10-percent investment credit for certain energy property (in addition to the regular investment credit). Property eligible for the general 10-percent energy credit included alternative energy property (e.g., solar, wind, or geothermal property), specially defined energy property, recycling equipment, shale oil equipment, equipment for producing natural gas from geopressured brine, and cogeneration equipment. The general energy credit for these types of property terminated after 1982, except that the credit is allowed through 1990 for long-term projects for which certain affirmative commitments (described below) were made.

A 15-percent energy credit is allowed through 1985 for solar, wind, geothermal, and ocean thermal property. Qualified intercity buses and biomass property are eligible for a 10-percent energy credit. For periods beginning on January 1, 1982 and ending on December 31, 1982, a 10-percent energy credit was allowed for chlor-alkali electrolytic cells. No affirmative commitment rule applies to these properties.

Qualified hydroelectric generating property is eligible for an 11-percent credit through 1985. The credit for hydroelectric property is allowed through 1988 under a special affirmative commitment rule.

***Application of the regular investment credit***

If energy property qualifies for the regular investment credit, both the regular and energy credits apply. In general, property eligible for the regular investment credit is tangible personal property, excluding buildings and their structural components, that is depreciable. Thus, for example, solar, wind, or energy air or water heating or cooling systems (which are structural components of buildings) do not qualify for the regular investment credit under present law although they do qualify for energy credits. However, in the case of qualified hydroelectric generating property that is a fish passageway, the regular investment credit, as well as the energy credit, is allowed for any period after 1979, without regard to whether such property otherwise qualifies for the regular investment credit.

### *Explanation of the Bill*

The bill would provide a 10-percent energy investment tax credit for investments in "qualified harvesting vessel equipment" for 1983, 1984, and 1985. The bill defines qualified harvesting vessel equipment as any of 11 specified items used aboard or installed in a vessel (i.e., a ship or barge) engaged in the harvesting of marine resources (i.e., fish and seafood) if the equipment reduces oil, diesel fuel or gasoline consumption. Under the investment credit rules, the equipment would qualify only if used on, or installed in, a vessel documented under the laws of the United States which is operated in the foreign or domestic commerce of the United States.

The 11 specified items are (1) a fuel flow meter, or fuel management digital microprocessor, (2) a hull speed meter, (3) a propeller thrust nozzle, (4) a variable pitch or two-speed propeller, (5) a large-bladed propeller, (6) a bow or side thruster, (7) a hull treatment, (8) a bulbous bow, (9) an on-board heat exchanger, (10) auxiliary sale equipment, and (11) automatic Loran C navigational apparatus.

Generally, a fuel flow meter or a fuel management digital microprocessor provides contemporaneous data on the rate of fuel usage in terms of gallons of fuel consumed per hour of running time. This information may help a captain identify when either poor sailing practices or poor maintenance are retarding the ship's performance. A hull speed meter acts in a manner similar to a speedometer except that speed is measured relative to the water rather than fixed geography. Since speed is difficult to judge accurately at sea (because fixed reference points are not readily available), a hull speed meter enables a captain to operate the ship's engines in their more efficient range.

A propeller thrust nozzle is a device which directs the exhaust of a ship's engines at the hub of the propeller. Thus, the exhaust is made to assist the motion of the ship. A variable pitch or two-speed propeller is one which enables the captain to, in effect, shift gears in the same manner that feathering the props on an aircraft changes the work load. A large- bladed propeller effectively allows a ship to develop forward motion at low engine speeds. Use of a large-bladed propeller is similar to installation of a transmission with lower than usual gears in a truck.

Bow and hull thrusters are water jets that assist in turning the vessel. The ability to turn rapidly would reduce the overall distance traveled (and thus the fuel consumed) by a vessel.

A hull treatment would be an antifouling paint or other treatment which prevents the buildup of seaweed or barnacles. Such buildups would cause a drag on the hull and thus increase energy consumption.

A bulbous bow increases the efficiency of a vessel by reducing the drag caused by turbulence.

On-board heat exchangers may be used to warm heavy fuel oil to make it more fluid before burning or to chill engine coolant. Both processes would increase energy efficiency.

An auxiliary sail may be used to augment, or substitute for, power from the fuel-burning engines.

An automatic Loran C navigational apparatus uses Coast Guard broadcast information to chart the ship's position. Use of a Loran

system reduces risks from navigational errors and may reduce fuel consumption by permitting ships to follow more direct courses.

### *Effective Date*

The bill would apply for property placed in service in 1983, 1984, and 1985.

## 4. S. 1809—Senator Baucus

### Exception for Regulated Investment Companies From Definition of Personal Holding Company

#### *Present Law*

Under present law, a 50-percent tax is imposed each year on the undistributed personal holding company income of a personal holding company (Code secs. 541-547). A corporation is treated as a personal holding company if (1) at least 60 percent of its adjusted ordinary gross income for the taxable year consists of personal holding company income (i.e., certain dividends, interest, rents, and royalties, as defined in the Code), and (2) at any time during the last half of the taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals. For this purpose, an individual is considered as owning the stock owned, directly or indirectly, by or for members of his or her family, or by or for a partner of the individual.

Under present law, certain corporations are excepted from the definition of personal holding companies. The excepted corporations include tax-exempt organizations, banks, domestic building and loan associations, life insurance companies, surety companies, foreign personal holding companies, lending or finance companies meeting certain active business and gross income tests, foreign corporations with no domestic shareholders, small business investment companies licensed by the Small Business Administration, and corporations subject to the jurisdiction of a bankruptcy court.

A regulated investment company ("RIC"), generally speaking, is a domestic corporation (other than a personal holding company) that issues shares to investors and invests the proceeds in securities. Regulated investment companies are generally treated as conduits for Federal income tax purposes (secs. 851-855).

#### *Explanation of the Bill*

Because of the attribution rule described above, under present law an investment company may be treated as a personal holding company, and fail to qualify as a RIC, if the shareholders of the investment company own limited partnership interests in the same partnership. Under the bill, a RIC would not be treated as a personal holding company if, at all times during the second half of the taxable year, (1) the company has at least 100 shareholders that are individuals or are treated as individuals, and (2) not more than 50 percent in value of the company's outstanding stock is owned, directly or indirectly, by or for five or less individuals. Further, for purposes of the rule attributing to an individual stock owned, directly or indirectly, by or for a partner of the individual, the term partner would not include any limited partners.

### *Effective Date*

The amendments made by the bill would apply with respect to taxable years ending on or after the date of enactment.

## 5. S. 2080—Senators Packwood, Moynihan, and Stevens

### Permanent Exclusion for Benefits Under Group Legal Services Plans

#### *Present Law*

***In general***

Under present law, amounts contributed by an employer to a qualified group legal services plan for employees (or their spouses or dependents) are excluded from an employee's gross income for income tax purposes (Code sec. 120) and from wages for employment tax purposes (secs. 3121(a)(17), 3306(b)(12)). The exclusion also applies to any services received by an employee or any amounts paid to an employee under such a plan as reimbursement for legal services for the employee (or the employee's spouse or dependents).

In order to be a qualified plan under which employees are entitled to tax-free benefits, a group legal services plan must fulfill several requirements with regard to its provisions, the employer, and the covered employees.

***Legal services***

A qualified group legal services plan must be a separate written plan of an employer for the exclusive benefit of employees or their spouses or dependents. The plan must supply the employees, their spouses, and dependents with specified benefits consisting of personal (i.e., nonbusiness) legal services through prepayment of, or provision in advance for, all or part of the legal fees of an employee or an employee's spouse or dependent.

Present law also provides that amounts contributed by employers under a qualified group legal services plan may be paid only (1) to insurance companies or to organizations or persons that provide personal legal services or indemnification against the cost of personal legal services, in exchange for a prepayment or a payment of a premium; (2) to organizations exempt from taxation as organizations described in section 501(c)(20) (see below for description); (3) to organizations described in section 501(c) that are permitted to receive employer contributions for one or more qualified group legal services plans, provided the organizations pay or credit the employer contributions to another organization that is described in section 501(c)(20); (4) as prepayments to providers of legal services under the plan; or (5) to a combination of the four permissible types of payment arrangements.

***Nondiscrimination***

In order to be a qualified plan, a group legal services plan must also meet requirements with respect to nondiscrimination in contributions or benefits and in eligibility for enrollment.

Present law requires that the contributions paid by an employer and the benefits provided under a plan may not discriminate in favor of employees who are officers, shareholders, self-employed individuals, or highly compensated. The plan must benefit employees who qualify under a classification that the employer sets up and that the Internal Revenue Service determines does not discriminate in favor of employees who are officers, shareholders, self-employed individuals, or highly compensated. However, in determining whether a classification is discriminatory, the employer may exclude from the calculations those employees who are members of a collective bargaining unit if there is evidence that group legal services plan benefits were the subject of good faith bargaining between representatives of that group and the employer.

A limit is placed on the proportion of the amounts contributed under the plan that can be applied for employees who own more than five percent of the stock or of the capital or profits interest in the employer corporation or unincorporated trade or business. The aggregate of the contributions for those employees and their spouses and dependents must not be more than 25 percent of the total contributions.

***Other rules***

Under present law, in order to be treated as a qualified group legal services plan, the plan must notify the Internal Revenue Service that it is applying for recognition of qualified status. If the plan fails to notify the IRS by the time prescribed in Treasury regulations, then the plan is not regarded as a qualified plan for any period before it in fact gave notice.

A self-employed individual who qualifies as an employee within the definition of Code section 401(c)(1) is also an employee for purposes of these group legal services provisions. This means that, in general, the term self-employed individual means, and the term employee includes, individuals who have earned income for a taxable year, as well as individuals who would have earned income except that their trades or businesses did not have net profits for a taxable year. An individual who owns the entire interest in an unincorporated trade or business is treated as his or her own employer. A partnership is considered the employer of each partner who is also an employee of the partnership.

***Group legal services organization***

Present law also provides that an organization or trust created or organized in the United States whose exclusive function is to form part of a qualified group legal services plan under section 120 is exempt from income tax (sec. 501(c)(20)). Such a trust is subject to the rules generally governing organizations exempt under section 501(c), including the taxation of any unrelated business income. An exempt organization or trust that receives employer contributions for a group legal services plan is not prevented from qualifying for exemption under section 501(c)(20) merely because it provides legal services or indemnification for legal services unassociated with a qualified group legal services plan.

***Termination***

The present-law exclusion for prepaid legal services and the tax exemption for group legal services organizations are scheduled to expire for taxable years beginning after December 31, 1984.

***Explanation of the Bill***

The bill would make permanent the exclusion from gross income for payments to or under a qualified group legal services plan and the tax-exempt status of group legal services organizations.

***Effective Date***

The bill would be effective on the date of enactment.

## Opening Statement of Senator Max Baucus

Mr. Chairman, thank you for holding this hearing regarding S. 1809. This legislation makes a technical correction in the tax rules governing regulated investment companies. This correction reverses an IRS ruling that prevents companies from qualifying as regulated investment companies solely on the ground that they are considered personal holding companies because of stock attribution among limited partners.

### BACKGROUND

Before 1935, federal tax laws discouraged middle-income investors from joining together, to diversify risks and obtain expert advice, the way wealthy investors did with their individual portfolios. This discouragement occurred because a group of middle-income investors who formed an investment company to jointly manage their investments would end up being taxed twice—once at the corporate level and once at the individual level.

To eliminate this double taxation, Congress enacted provisions that essentially exempt regulated investment companies ("RICs") from tax. (Revenue Act of 1936, sec. 13(a)(2), 48(e), 49 stat. 1648, 1665, 1669 I.R.C. sec. 851-53 (current version)). The basic concept underlying these provisions is that investment companies that "submit to public regulation and perform the function of permitting small investors to obtain the benefit of diversification of risks" should be exempt from tax at the corporate level. (H. Rep. 1681, 74th Congress, 1st Sess. (1935), reprinted in 1939-1 C.B. (Part 2) 642, 644 (letter from President Roosevelt to Cong.; H. Rep. 2020, 86th Cong., 2nd Sess. 3-4 (1960))

To qualify as a RIC, a company must meet several requirements. For example, it generally must be registered under the Investment Company Act of 1940, I.R.C. sec. 851(a)(1); must derive at least 90 percent of its income from investments, I.R.C. sec. 851(b)(2); and must distribute at least 90 percent of its annual investment income as shareholder dividends, I.R.C. sec. 852(1).

### THE PERSONAL HOLDING COMPANY EXCLUSION

Another requirement is the one relevant here. Congress intended to deny tax-exempt RIC status to closely-held corporations that were not diversifying risks for many investors but instead effectively serving as holding companies for one or a few investors. To accomplish this, it provided that a RIC must not be a "personal holding company" ("PHC") within the meaning of section 542. (I.R.C. sec. 851(a).) Generally, section 542 provides that a company is a PHC if at least 60 percent of its adjusted ordinary gross income is personal holding company income and more than 50 percent of its stock is actually or constructively owned by five or fewer people. (I.R.C. sec. 542(a), 544(a).) Since most investment companies automatically will meet the income test, the effect of the exclusion is to deny RIC status to investment companies which meet the stock-ownership test. A company meets the stock ownership test, again, if over 50 percent of its stock is actually or constructively owned by five or fewer people. For this purpose, a partner is deemed to constructively own any stock owned by other members of the same partnership. I.R.C. sec. 544(a)(2).

Turning to the specific problem, section 544(a)(2) does not distinguish between active and limited partners. Consequently, if any number of people owning 51 percent of the investment company's stock have limited partnership interests of any size in any of five totally unrelated limited partnerships, a literal application of sec. 544(a)(2) would prevent the investment company from qualifying as a RIC. Many other combinations could produce the same result.

To determine whether so literal a reading of section 544(a)(2) was correct, in 1979, an investment company asked the IRS whether the IRS could deny RIC status to investment companies which met the stock-ownership test only because of constructive ownership attribution among limited, rather than active, partners. In a private letter ruling, the IRS replied that it would not. In 1982, however, the IRS reversed its position, holding that, for RIC purposes, section 544(a)(2) requires stock ownership to be aggregated between limited partners in syndicated limited partnerships, without discussing the closeness of the limited partners' business relationship. (Rev. Rul. 82-107 82-1 C.B. 103.)

As a result of this ruling, the stock ownership partner-attribution test of present law can prevent a publicly-owned investment company from qualifying as a RIC, if, unkown to each other, some of the shareholders of the company happen to invest in one or more unrelated limited partnerships.

*This result is unintended and anomalous.* Indeed, Assistant Secretary Chapoton recently wrote that "Treasury believes that the historical purpose of the RIC provisions—to permit small investors to obtain the benefits of investment diversification and professional management through a widely-held investment vehicle taxed in a manner comparable to direct ownership of securities—is not served by denying RIC status to an investment company with a large number of unrelated individual shareholders merely because some of them have passive limited partnership investment in common."

S. 1809

Mr. Chairman, S. 1809 would amend section 542(c) of the Code to reverse the 1982 revenue ruling. That way, it would reflect Congress' original—and continuing—intent that the RIC provisions should not be available to certain closely-held corporations. But, in contrast to current interpretation of the law, it would permit a company to qualify as RIC if it has many shareholders and meets the current PHC test only because of construction ownership attribution among limited, not active, partners.

Specifically, the bill provides that an otherwise qualifying RIC will not be a PHC (and will therefore continue to qualify as a RIC) if at all times during the last half of such corporation's taxable year it has at least 100 actual shareholders who are individuals (or organizations treated as individuals by ITS sec. 542(a)(2)) and does not satisfy the PHC stock ownership test applied without attribution of stock ownership to or from a limited partner.

CONCLUSION

Mr. Chairman, this bill is revenue neutral and is supported by the Treasury Department.

At the same time, the Treasury Department, as well as the Investment Company Institute, support a broader solution than generally permits PHCs to qualify as RICs. This alternative solution is perfectly satisfactory to me, and I am delighted that the Finance Committee has incorporated a privision embodying such a solution in the tax package we approved last night.

Senator PACKWOOD. The hearing will come to order.

We have a series of bills before us today, but the first ones are a group: S. 146, S. 1332, and S. 1768. I might say to those involved, this is a subject with which I have some degree of familiarity. It comes before this committee frequently.

I support your position. We have the same problem in Oregon with our fishing fleet, but to a lesser degree than does Maine.

Senator Mitchell is here to share the podium with me, and Senator Cohen is here as our first witness.

Senator Mitchell, do you have an opening statement?

Senator MITCHELL. Thank you, Mr. Chairman. I do.

Since three of the bills on which the committee will receive testimony this morning were introduced by me and directly affect the fishing industry, I thank you, Mr. Chairman for scheduling this hearing and giving the industry an opportunity to present its views on these bills.

I will discuss briefly just one of them, the most important of the three, and that is S. 146, which would permanently resolve a problem which fishermen in Maine and other parts of the country have with the Federal unemployment tax.

In 1981 I introduced legislation known as the Stern Man Unemployment Tax Act, which sought to correct an illogical and inconsistent aspect of the tax laws affecting our nation's commercial fishing industry.

The problem expressed simply is this: For two major tax laws, the Federal income tax and the social security tax, vessel operators are permitted to consider their crewmembers as independent con-

tractors. For a third law, the Federal unemployment tax, the operators are required to consider their crewmembers as employees.

The way I see it, these crewmembers are either independent contractors or they are not. It makes no sense to classify them one way for two tax statutes and another way for a third statute.

My bill recognized that most commercial fishermen are by definition self-employed. The fisherman considers himself to be self-employed, and the operator of the vessel on which he fishes considers him to be self-employed. They both know that fishermen do not receive, in most instances, the fixed salaries that employees traditionally receive. Instead, fishermen receive what is called a share of the catch or proceeds from the share of the catch

My 1981 bill was based on this understanding of the way fishermen receive this income, and so too was the amendment to the 1981 Economic Recovery Tax Act offered by my colleague Senator Cohen; that amendment, which covered calendar year 1981, permitted operators to treat their crewmen uniformly for purposes of all three tax statutes.

In late 1982 I was successful in extending the 1981 policy through the end of calendar 1982 and am now engaged in a similar effort to extend the policy through the end of calendar year 1984.

As you know, Mr. Chairman, yesterday the Finance Committee approved that provision in the tax package we are now marking up, to extend that policy through 1984.

The bill before this subcommittee, which both Senator Cohen and I support, would make this policy permanent. The bill enjoys support from fishing industry representatives from all coasts and deserves this subcommittee's approval it will, I hope, ultimately be enacted into law as a permanent policy.

I look forward, Mr. Chairman, with you to receiving the testimony of Senator Cohen and the other witnesses on this and the other legislation that is now pending.

Senator PACKWOOD. George, thank you.

I might say to the witnesses that, with the exception of Senators and members of the administration we try to keep our testimony to 5 minutes. All of the testimony will be in the record. And I can assure the witnesses today, not only on the fishing issue but on the others, it is one that both Senator Mitchell and I are well familiar with.

We are delighted to have as our first witness Senator William Cohen, the senior Senator from Maine.

Bill.

## STATEMENT OF HON. WILLIAM S. COHEN, U.S. SENATOR FROM THE STATE OF MAINE

Senator COHEN. Thank you very much, Mr. Chairman and Senator Mitchell. I will come in well under the 5-minute mark, if I can, to help expedite these matters.

Let me join with Senator Mitchell in focusing the emphasis upon the last bill he mentioned, with respect to FUTA.

He has been actively involved in the situation since becoming a member of the Senate. Back in 1975 I introduced the Sternman's Act in the House of Representatives, and when I was over there

the exemption became part of the 1976 act for purposes of FICA and purposes of withholding of income on the part of the so-called employers.

With respect to FUTA, this issue that has come up time and time again, where the IRS has failed to recognize the true status of these individuals. They are, in fact, independent contractors, and it seems to me to create an incredible hardship for these small boatowners to year after year have to come back to Congress and say, "Well, can you extend the exemption for another year, or 2 more years?" It really does deserve to be part of our permanent law, and it is totally inconsistent to treat these individuals as independent contractors for one purpose, where over here they are treated as an employee. And the bookwork and paperwork is imposing an incredible burden on small boatowners engaged in the fishing industry. We ought to change it permanently, and I want to join with Senator Mitchell in urging that upon you. It would make it a much more predictable and equitable situation.

So, I would lend my strong support for making the exemption, which I am told will be extended for 2 more years under the budget reduction effort that is now underway with the Finance Committee, but I really don't see why we should postpone a permament solution another 2 years, and then have the individuals come back and say, "You've done it to us again." We ought to take care of it once and for all.

On the other two items, before going on, Don Young, the Congressman from Alaska, has written to Chairman Dole, back in November. He would like to have his original letter submitted as part of the record. He also touches upon these three measures, and I will just dwell briefly on these two:

One would be to extend the ability of boatowners to have a full 10-percent tax credit for their capital expenditures under the Capital Construction Fund.

It seems to me that, even though there is a provision in the law which says that they can petition the Court of Claims to have the credit extended from 5 to 10 percent, that really only applies to the major and larger boatowners. Small people simply can't afford the time, don't have the expertise or the ability to take advantage of that provision. And it seems to me it would be wise to help our fishing industry by allowing the full 10-percent investment tax credit to be extended.

Also, we ought to anticipate that in all likelihood the CCF will be extended, not only from ships but to shore activities as well. As we move into more and more capital expenditures for processing plants, then I think it is predictable that we are going to be extending that to the shore facilities. So it would make sense to allow the full 10 percent.

A final point would be allowing for energy conservation measures to be fully taken advantage of by our fishing fleet.

I would just say, Mr. Chairman, our fishing industry is in trouble, and it's in trouble for a whole host of reasons. We now have a 332 investigation going on into practices by the Government of Canada, and we find that our fishing industry has to compete not only against the Canadians but against the Canadian Government—the treasuries of Ottawa and the Provinces.

Here is one area where I know you have been a leader, in the field of energy conservation, and it seems only wise policy to allow energy conservation to be extended to those who make renovations and purchase equipment which is going to cut the consumption of fuel.

I submitted some lengthy testimony, which I hope you will include in the record, but we have small boatowners who may use as much as 2,000 gallons a week, and may go up to 10,000 gallons a week. Not only is that a large expenditure on their part, a waste in some cases of fuel, but they have to compete against Canadians, Japanese, and others whose governments subsidize fuel purchases. So we are paying top dollar, we are using inefficient equipment in many instances, and here we have an opportunity to give this incentive, which we give to other industries which we ought to extend to the fishing industry if we are truly going to carry out the Magnuson Fishery Conservation and Management Act and the American Fisheries Promotion Act in trying to promote a strong fishing industry. Well, those are a lot of words, and we have the chance now with these three very important bills to make it part of our deeds, to cut down on the trade deficit. Our Commerce Department has indicated we could perhaps reduce that trade deficit by half in the fisheries industry by making these small changes.

So I hope that you will give every consideration to moving quickly on those three measures which I believe in and join with Senator Mitchell in promoting for our industry.

Senator PACKWOOD. Bill, thank you. They will have my full support.

[Senator Cohen's prepared statement and the letter from Don Young to Senator Dole follow:]

STATEMENT OF SENATOR WILLIAM S. COHEN

Mr. Chairman, I am pleased to have the opportunity today to comment on three bills that, if enacted, will be of great benefit to the commercial fishing industry of my state. I thank the subcommittee for its consideration of these important measures.

The United States, under the provisions of the Magnuson Fishery Conservation and Management Act and the American Fisheries Promotion Act amendments, is committed to the development of a strong, competitive fishing industry and to the full utilization of our strategic fishery resources by our domestic fisherman. The Commerce Department has reported that the full development of just eight of our fisheries, including the mackeral and ground fish fisheries off the coast of Maine, would increase vessel revenues by $800 million, would increase our Gross National Product by $1.2 billion, and would cut our $3 billion fisheries balance of trade deficit nearly in half. We should make every effort to encourage this growth, and the legislation that the subcommittee is considering today would aid substantially in the realization of this goal.

S. 146

The first bill that I want to discuss is S. 146, legislation that I introduced with Senator Mitchell more than a year ago. This legislation would provide a permanent exemption from the Federal Unemployment Tax Act (FUTA) to many boatowners who are engaged in the halibut or salmon trade or whose vessels are over ten net tons.

The issue which this legislation addresses in not new, but would end a long effort to correct a very unfair interpretation of tax law as it affects an historically independent and proud group of working people—commercial fisherman. These self-employed workers are professionals who work as independent contractors year-round in various fisheries depending upon the seasonal availability of their catch. They do

not collect unemployment benefits, although the boat owners have been required to pay into the FUTA system by the Internal Revenue Service (IRS).

Because these self-employed commercial fishermen will move from boat to boat during the year in search of larger shares of catches on better producing vessels, the boat owner is saddled with an additional burden. On a vessel with a crew of four, for example, the high turnover rate in the fisheries may result in seven or eight crewmen working on that boat over a one year period. Consequently, the boat owner's payments into the FUTA system are often double those of other employers in small businesses even though the wages earned are considered earned by self-employed workers for all other tax considerations.

I have been stressing the need to make our tax laws conform to the independent nature and self-employed status of commercial fishermen for many years now, and this permanent FUTA exemption is the final hurdle in that goal.

In 1975, while serving as a member of the House of Representatives, I introduced the Sternman's Exemption Act which became a part of the Tax Reform Act of 1976. At that time, the IRS was enforcing an agency ruling which held that certain fishermen, known as sternmen in the lobster industry, could not be considered independent workers but were employees of the boatowners with whom they happen to work.

This view of the relationship of the sternmen and the boatowners could not have been further from reality. For decades, Maine sternmen and boatowners had worked with the understanding that the sternman was an independent contractor. Their relationship was born of both practicality and the independent nature of these individuals. The sternmen's competency is respected by the boatowner to the point that he is expected to be able to take control in an emergency situation and, sometimes, fish the boat should the owner become temporarily disabled.

The advent of IRS' novel rulings into this field placed a great strain on the resources of the independent boatowners in the state of Maine and elsewhere. It forced some to the brink of bankruptcy and others to pursue the very dangerous practice of going out in their boats alone.

The Sternman's Exemption Act corrected this intolerable state of affairs and allowed those fishermen who are paid a share of the catch and who work on vessels with crews of less than 10 people to be exempt from the tax imposed by the Federal Insurance Contribution Act (FICA). In addition, the wages received by those fishing boat crew members, whose services were exempted for purposes of FICA, were no longer considered to be wages for purposes of income tax withholding, and those crewmen are considered to be self-employed for purposes of the Self-Employment Contributions Act.

Under current law, if crew members meet these criteria, boatowners are exempt from social security or income tax withholding requirements.

S. 146, besides giving further congressional recognition to the practice of hiring fishermen as independent contractors, will bring the Federal Unemployment Tax Act into conformity with the other laws that I have mentioned. The legislation does not penalize those individuals who wish to work as employees on fishing boats, but it provides those who do not with an opportunity to prove that they are self-employed and to retain their professional independence.

As I have said, the issue which S. 146 addresses is not new. In 1978, S. 3080, an identical bill, was the subject of hearings in the full Finance Committee and, in 1980, S. 1194, another identical bill, was considered by this subcommittee. No further action was taken on either of these bills.

The first bright spot in this long effort appeared in 1981, when another identical bill, S. 791 passed the Senate. The language of that legislation would have applied the FUTA exemption to wages paid after December 31, 1980. Unfortunately, the conference agreement on the bill made the exemption effective only for the tax year 1981.

In October of 1982, the Miscellaneous Revenue Act provided another temporary exemption for tax year 1982.

Since January 1, 1983, commercial fishing vessel owners and operators have been, once again, subject to inappropriate FUTA withholding requirement burdens for the wages of their crewmen and are considered to be self-employed, independent contractors for the purposes of all other employment taxes. This piecemeal approach to a change in an inequitable tax law, that would have absolutely no adverse effect upon the U.S. Treasury, has caused a lot of unnecessary confusion. It has also cost our nation's fishing industry time and money. This situation needs to be addressed.

S. 146 would permanently end the confusion that currently clouds tax policy in the fishing industry and complete the reestablishment of a working relationship that has served independent boatowners and fishermen well in my state for decades. This is important legislation and its passage should be expedited.

S. 1332

S. 1332, a bill that would provide a full 10 percent investment tax credit for capital expenditures that are made with funds accumulated in Capital Construction Fund Accounts, would also correct an inequity in our tax law that works to the disadvantage of our commercial fishing industry.

For fishermen, the Capital Construction Fund (CCF) encourages the formation of capital for investments in new or reconditioned fishing vessels by deferring the payment of federal taxes on income earned from the operation of an existing vessel. I would like to emphasize at this juncture that these taxes are only deferred. The IRS regains these deferred revenues by requiring a reduction in the depreciation allowance for property acquired with CCF funds over the depreciable life of the asset. This fact is important to keep in mind when considering the revenue effect of S. 1332.

Since the CCF program was expanded to include the commercial fishing industry in 1970, nearly $500 million has been raised to expand the industry's harvesting capability. The CCF program has been of significant benefit to U.S. fishermen since that time, allowing them to employ the modern technology needed to compete more successfully with their counterparts from other nations. Most foreign fishermen enjoy government subsidies far more substantial than any incentives provided to our fishermen by our government today.

I want to make clear that I am not advocating a panoply of subsidies for the domestic fishing industry, but only suggesting that the incentives that we now provide to other industries could be fine tuned to give our fishermen and fish processors a keener competitive edge. S. 1332 provides a case in point.

Although the extension of the CCF program to the domestic fisherman has been of great benefit, the 1976 Tax Reform Act Imposed a Restriction upon the use of CCF investment tax credits which has acted to reduce the incentive for fishermen to establish CCF accounts in favor of more costly financing arrangements. As a result, the full benefit of the CCF program for seafood harvestors is not being fully realized.

Due to the restrictions of the 1976 Act, CFF holders are allowed only a five per cent investment tax credit on their CCF investment instead of the full 10 per cent investment tax credit allowed for other capital investments. The 1976 Act does allow CCF holders to petition the Court of Claims for the full credit, but this remedy is beyond the reach of the average commercial fisherman. Thus, he is effectively prevented from taking full advantage of the incentives available through the CCF program that are commonly made available to merchant marine interests who hold CCF accounts.

Large shipping companies using CCF accounts have the financial resources and legal experience available to them to approach the Court of Claims to argue for the full 10 per cent investment tax credit, and all of the companies who have done so have been successful. The vast majority of fishing vessel owners, however, are small businessmen who operate their own boat and do not have the time, money, or legal resources to take advantage of the Court of Claims' review. This situation is unfair and needs to be rectified.

Since the majority of CCF accounts for merchant vessels are eligible for a 10 per cent investment tax credit today through successful litigation before the Court of Claims, equity dictates that the independent small businessman of limited means who works as a commercial fisherman should be given the same incentive to raise new capital.

Passage of S. 1332 would restore the incentive to accumulate CCF capital for commercial fishing vessels that was severly diminished by the 1976 Tax Reform Act. I urge the members of this subcommittee to favorably report the bill to the full Finance Committee as soon as possible.

S. 1768

S. 1768, a bill that would provide business energy tax credits for energy-saving equipment purchased for use on board commercial fishing vessels, presents another opportunity to provide our fishing industry with the same tax advantages enjoyed by other American industries today. Passage of the legislation could result in more than a 20 per cent reduction in fuel consumption for any fishing vessel whose owner takes full advantage of the tax credit incentives which the bill provides.

I am pleased to see such an extensive list of energy-saving devices in the bill, but I would like to suggest one additional item to the subcommittee. The diesel fuel preheater can increase the fuel efficiency of most diesel engines by more than 10 per cent by itself, is used by the industry today, and should be added to the list.

Although the small businessman working as a commercial fisherman has the same economic incentive to save energy as every other businessman in the country, the fisherman alone is not allowed the advantages of the Energy Tax Act of 1978. S. 1768 would amend the energy property definition of the Internal Revenue Code to allow fishermen to take a 10 per cent energy tax credit when they invest in equipment to be used onboard their vessels that will allow them to conserve fuel.

Few American industries are in greater need of tax credits for energy conservation than the fishing industry, where fuel demands are enormous. The largest expense of a commercial fishing trip is the cost of fuel. Fishermen will often travel hundreds of miles a week hunting the ocean for various species of fish, while operating their engines continuously, even if they stop their vessel to sleep.

Fuel consumption on fishing vessels can range from 10 to 20 gallons an hour, for small to medium sized draggers whose weekly fuel demands can exceed 2,000 gallons, while some of the larger offshore vessels can burn up to 10,000 gallons a week. In addition to this demand while the U.S. fisherman must pay full price for the fuel he uses, his competition from Canada, Iceland, Japan, and other countries around the world are provided with substantial fuel subsidies by their governments.

The emphasis on conserving energy has seemingly diminished in recent months, although the importance of doing so has not. Congress should, in my opinion, continue the practice of encouraging the conservation of energy resources by rewarding those businesses who attempt to do so. By extending energy tax credits to the fuel-intensive commercial fishing industry, we will be helping to secure a more competitive position for our fishermen, while providing them with an incentive already enjoyed by many other businesses who have acted responsibly to become more energy efficient.

Mr. Chairman, prompt passage of these three bills would correct three inequities in existing tax law which operate to the disadvantage of our commercial fishermen. Resolving these inequities would aid in the growth and development of our domestic fishing industry. It is my sincere hope that the subcommittee will expedite the passage of these measures.

Thank you for the opportunity to be here today.

DON YOUNG
CONGRESSMAN FOR ALL ALASKA

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November 14, 1983

Honorable Robert Dole
Chairman, Committee on Finance
U.S. Senate
SD 221 Dirksen Bldg.
Washington, D.C. 20510

Dear Chairman Dole:

I understand that the Committee on Finance will hold hearings on three bills (S 146, S 1332, and S 1768) on Thursday, November 17, 1983. Because these bills are of great importance to the continued development of the U.S. fishing industry - an industry that provides significant economic benefits to the nation and to the State I represent - I want to go on record as supporting their immediate passage.

S 146, which exempts certain fishing vessels from the Federal Unemployment Tax Act, will make permanent an exemption that has been in effect for two years. As a sponsor of a similar measure in the 96th Congress, I am aware of how important this bill is to U.S. fishermen. Because of the seasonal nature of many fisheries and the fact that many crew members are paid on a share system, fishing vessel owners face an almost impossible task of maintaining FUTA records. In addition, many crew members work in the fishing industry during part of the year and in other industries during the rest of the year. Thus, they are never unemployed, even though they are not always employed as fishermen. The State of Alaska has recognized this unique situation by making the payment of state unemployment taxes voluntary. The federal government has declined to adopt such an approach, leading to the passage of the exemption in the last two Congresses.

Because fishing vessel owners must begin keeping records on January 1st, it is imperative that passage of this bill be expedited. I do not believe that the existence of the exemption has caused any major problems during the last two years and I hope it will be made permanent.

S 1332 will allow favorable depreciation treatment for vessels used to contribute to Capital Construction funds established under the Merchant Marine Act of 1970. The CCF program is extremely beneficial to the fishing industry as it provides a source of capital for the construction or reconstruction of vessels. As U.S. fishermen continue to move into new fisheries that have in the past been dominated by foreign vessels, they need new types of fishing gear, new vessel configurations, and - on occasion - new vessels. If we are to carry out the policy of full utilization of the bottomfish resources in our 200 mile Exclusive Economic Zone - as that policy was established by the Congress with passage of the Fishery Conservation and Management Act in 1976 - we need to ensure that U.S. fishermen have the resources necessary to do the job. S 1332 will certainly help in this regard.

S 1768 is another measure designed to increase the ability of our domestic fishing fleet to harvest the fisheries resources in our 200 mile zone. This bill will allow fishermen to take energy tax credits for certain equipment installed on fishing vessels, equipment that not only helps to increase the U.S. harvest of fish but also conserves scarce energy supplies. Similar tax credits have been granted to other industries and I see no reason why the fishing industry should not receive equitable treatment.

Last year, the balance of trade deficit in fisheries products alone accounted for approximately 10% of the total national balance of trade deficit. Over 50% of the seafood consumed in this country is imported. In coastal States, the fishing industry represents a significant portion of the economy. Fishermen are food producers, yet they have not asked for - and do not receive - the many benefits available to other food producers in the U.S. These bills will result in little, if any reduction, to national revenues, but will enable our fishermen to compete on the world market and thereby increase our national economic position. I urge you to take prompt, positive action on these measures.

Sincerely,

DON YOUNG
Congressman for All Alaska

DY:rhm

35-046 O—84——3

Senator PACKWOOD. I have no questions.

George?

Senator MITCHELL. No, Mr. Chairman. I merely want to commend Senator Cohen for his past and present activities in behalf of these bills and the fishing industry in general.

Senator PACKWOOD. Thank you.

Next, we will hear a panel with Lucy Sloan, the executive director of the National Federation of Fisherman; Sam Davidson, consultant and CPA for Davidson Associates in Portland, Maine; Wilma Anderson, and Eldon Greenberg.

Lucy, do I understand you are going to go first and then introduce the others?

Ms. SLOAN. Yes.

## STATEMENT OF LUCY SLOAN, EXECUTIVE DIRECTOR, NATIONAL FEDERATION OF FISHERMEN, WASHINGTON, D.C.

Ms. SLOAN. Thank you.

I will start with Sam Davidson, who is an accountant from Maine, who is here on behalf of the Maine Fishermen's Cooperative Association.

Wilma Anderson is a director of Texas Shrimp Association, an accountant, and a vessel owner. She has interest in three vessels.

Chris Vehrs is the Washington representative of the Texas Shrimp Association.

And Eldon Greenberg is with the Southeastern Fisheries Association.

We do appreciate the opportunity to have this forum in addition to the Commerce Committee to discuss these problems with you. When Senator Mitchell suggested the possibility of discussing fisheries financial legislation before the Finance Committee, we were very greatful; because you are familiar with these problems from the Commerce Committee side, but to have the additional forum means a great deal to us, because as we become increasingly sophisticated in our small business operations, the finances of those operations become increasingly important. With narrow margins on which our people operate, the three bills which we are here to consider today are of particular interest to us as we try to upgrade our fleets and move into underutilized species.

I would like to ask Sam to go first. He is going to give an overview of all three of the issues. I would say, having discussed with him these issues and with his members, that he accurately reflects the concerns our fishermen have all over the country.

I would then ask Wilma to talk. She is involved with all three of the issues, but today she said she was going to emphasize FUTA.

Eldon will talk about the tax credits, and I think Chris will make some remarks in summary, if she chooses to.

I would only say that I will be happy to take any questions; but since we have discussed this matter in some detail, I don't think I need to take your time with it today.

Sam?

[Ms. Sloan's prepared statement follows:]

national federation of fishermen
Suite 516
2424 Pennsylvania Avenue, N.W.
Washington, D.C. 20037
(202) 554-3272; (202) 659-9833

16 March 1984

Testimony before
SENATE CTTE ON FINANCE
on
S 146, S 1332, S 1768

Good morning, Mr. Chairmain, Senators. I'm Lucy Sloan, Executive Director, National Federation of Fishermen. NFF is theonly national organization of commercial fishermen. We represent a majority of the organized commercial fishermen fishing in the United States exclusive economic zone. Our members fish from Mexico to Alaska and from the Gulf of Maine to the Gulf of Mexico. Among the species they harvest are groundfish, salmon, crab, albacore tuna, shrimp, Pacific whiting, pollock, swordfish, lobster, cods, and clams.

We appreciate the opportunity to discuss with you the three fisheries financial bills before you today. The Federal Unemployment Tax Act amendment, the 10% investment tax credit on Capital Construction Funds, and the energy tax credit for certain equipment for the fishing fleet, were you to enact them, would be additional important steps toward helping to create a more favourable economic environment for the fishing industry's efficiency and growth.

The Federal Unemployment Tax Act (FUTA) amendment, S 146, would correct a curious inconsistency in the fishermen's tax status. Although we've had temporary exemptions, the problems this inconsistency represents should be resolved finally and permanently to avoid continued serious confusion among our fishermen as to their tax status in the eyes of federal law. Both the Internal Revenue Service and the Federal Insurance Constribution Act acknowledge fishermen as independent contractors--all fishermen, captain and crew alike. FUTA does not. Clearly, this is absurd. Not only does it put a quite unnecessary and an unwarranted burden on those small businesses as regards paperwork, but it also deprives boatowners varying amounts of capital during the course of the year. Fishing operating margins are not great. To diminish these through this foolish inconsistency is economically counter-productive to the United States Treasury.

We are grateful to your and your colleagues for the help you have given us on this perplex, and we look forward to resolving it finally soon.

The 10% investment tax credit on Captial Construction Fund monies, S 1332, would remove another financial inconsistency for fishermen in our fiscal laws. Surely the United States fishing fleet is as important to the communities in which our fishermen work and live as is the commercial fleet to the ports from and among which they operate. But the law as it is presently written is functionally inequitable because our relatively much smaller businesses usually do not include

as part of their standard operating procedures either the knowledge or the resources to ensure that the full 100% investment tax credit is part of a fisherman's vessel investment. And thus, although the CCFs can be an effective tool for vessel construction or improvement in our fishing fleet, our people risk not getting what, depending upon the size of the vessel, could be a not insignificant amount of money. This can be particularly important when a fisherman is building a new vessel or substantially rebuilding an older one, because his earning curve with the new or altered vessel may go up more slowly than has been his case with known equipment.

As we seek aggressively to upgrade or to expand our fleets in many fisheries, the more straightforward capital advantage which this amendment would provide could be even more productive than this program has been in the past.

Extending energy tax credits for certain equipment for the fishing fleet, S 1768, would redress another inequity between fishermen and other better-understood small businessmen ashore. While the latter are able to get energy tax credits if they install more fuel-efficient equipment in several phases of their operations, our people are not yet able to do so. For an industry where fuel costs have gone from negligible to significant operating costs in less than five years, the proposed energy tax credits combined with various amounts of fuel savings which could result from installation of these kinds of equipment could improve the operating margins and thus, in some fisheries, increase the flexibility fishermen would have to move among fisheries or into new ones. In addition to the equipment which S 1768 includes, our people have suggested more energy efficient engines and specially designed nets and doors for the trawl fisheries.

To sum up, each of these three bills would provide incremental advantages to US fishermen, small businessmen whose potential for increased productivity both the Magnuson Fishery Conservation and Management Act and the President's exclusive economic zone Proclamation policy statement strongly support. We would like to work with you to ensure that we will be able to realize these advantages.

Thank you again for your interest and your support.

## STATEMENT OF SAM DAVIDSON, CONSULTANT AND CERTIFIED PUBLIC ACCOUNTANT, DAVIDSON ASSOCIATES, PORTLAND, MAINE

Mr. DAVIDSON. Thank you, Mr. Chairman and Senator Mitchell.

First of all, I would believe that some thanks is in order, for I understand that a 1983 and 1984 exemption on FUTA has been attached as a part of the deficit reduction bill, and I certainly hope that will go through expeditiously. And for your part in that, thank you.

To go on, Mr. Chairman, I believe you have my written testimony, and I would like to have that entered into the record.

Senator PACKWOOD. Your statement will automatically be included in the record as if you had read it in full.

Mr. DAVIDSON. Thank you.

On the FUTA, we really do need to make that permanent. We have touched on that for a number of years now. We have the fishermen and the crew members leaning in one direction. We would like to keep them going in that direction.

I have found in my experience in Maine and throughout New England that this relationship between the boats and the crew members is not one of an employee-employer relationship but is more as joint venturers or partners. Further, as I am sure you are well aware, such things as normally high crew turnover, a migrating workforce, the catch participation system, and other normally uncontrollable variables such as weather and fish migration patterns make such definitions as unemployment and lack of work very difficult to understand and to put in place.

Further, the exemption in 1981 and 1982 that has already taken place has saved an average fishing vessel from around $2,000 to $8,000, and perhaps more in some cases with the larger vessels. This money predominately has basically been put back into the vessel to improve the vessel's harvest efficiency.

Further, in 1981 and 1982 I had approximately 115 crew-member clients—not fishing vessel owners but crew members. No one, not to a man, or a woman in this case, have complained about the lack of unemployment benefits. There has been virtually no issue. So I don't see any high level acrimony at the lost level of benefits.

In summary, then, the unemployment system doesn't seem to fit well within the fishing industry. Removing the tax in 1981 and 1982 has resulted in considerable savings to the boats, and crew members seemingly have not complained.

I urge you, I sincerely urge you, to make this permanent.

Going on to the issue of the full 10-percent investment tax credits, as you are well aware, the capital construction fund, coupled with the investment tax credit has been a very effective tool in our fleet expansion. Now, although fleet growth has slowed, there are many matters that need to be addressed in terms of putting capital in place—such matters as harvest efficiency, harvest technology, and product quality are all important. I would urge you to put the full investment tax credit in place.

Senator PACKWOOD. Thank you.

[Mr. Davidson's prepared statement follows:]

TO: SENATE FINANCE COMMITTEE

FROM: SAM DAVIDSON

RE: PROPOSED BILLS ON: (1) CONTINUED FUTA EXEMPTION FOR FISHING VESSELS TAKING LESS THAN 10 CREWMEMBERS, (2) FULL 10 PERCENT TAX CREDIT ON VESSELS AND RELATED EQUIPMENT FUNDED BY CAPITAL CONSTRUCTION FUND WITHDRAWALS, (3) ENERGY TAX CREDIT AS IT RELATES TO CERTAIN FUEL SAVING DEVICES FOR FISHING VESSELS.

MR. CHAIRMAN, AND MEMBERS OF THE COMMITTEE, I AM A FISHERIES CONSULTANT AND CERTIFIED PUBLIC ACCOUNTANT WHOSE CLIENT BASE CONSISTS LARGELY OF FISHING VESSELS OPERATING ALONG THE MAINE COAST. SPECIFICALLY, I CONSULT TO APPROXIMATELY 35 VESSELS, RANGING IN SIZE FROM 34 FEET TO 108 FEET, AND OPERATING FROM THE PORTS OF KENNEBUNKPORT, EAST TO STONINGTON. IN ADDITION, MY CLIENTS INCLUDE THE MAINE FISHERMAN'S COOPERATIVE ASSOCIATION, THE VINALHAVEN FISHERMAN'S COOPERATIVE, THE BOOTHBAY FISHERMAN'S COOPERATIVE, AND THE PINE POINT FISHERMAN'S COOPERATIVE, AGGREGATING APPROXIMATELY 275 VESSEL OWNERS. AS WELL, I PROVIDE TAX AND FINANCIAL ADVICE TO ABOUT 90 NON-VESSEL OWNING CREWMEMBERS.

MY TESTIMONY WILL REFLECT THE SENTIMENT OF BOTH MY CLIENTS AND OTHER MEMBERS OF THE VESSEL SECTOR.

WE WHOLEHEARTEDLY FAVOR AND ENDORSE THE CONTINUED FUTA EXEMPTION, THE FULL INVESTMENT TAX CREDIT ON CAPITAL CONSTRUCTION FUND WITHDRAWALS, AND THE ENERGY TAX CREDIT AS IT RELATES TO FISHING VESSELS; SUCH MATTERS AS PRESENTLY BEFORE THE COMMITTEE.

ON THE MATTER OF A CONTINUED FEDERAL UNEMPLOYMENT TAX EXEMPTION FOR FISHING VESSELS TAKING LESS THAN 10 CREWMEMBERS, PRIOR EXEMPTIONS IN 1981 AND 1982 HAVE SAVED VESSEL OWNERS THOUSAND OF DOLLARS IN EACH OF THESE YEARS IN FEDERAL AND STATE UNEMPLOYMENT TAXES. THIS HAS BEEN OBVIOUSLY BENEFICIAL AND WE NEED ITS CONTINUANCE.

AS MENTIONED IN PRIOR TESTIMONY BEFORE THIS COMMITTEE, THIS RE-DEFINED EXEMPTION RATIFIES AND ENHANCES THE TRUE ECONOMIC RELATIONSHIP THAT EXISTS BETWEEN CREW AND VESSEL; ONE OF PARTNERSHIP OR JOINT VENTURE. EACH DEPENDS ON THE OTHER FOR HELP IN GETTING A DIFFICULT JOB DONE. THERE NEVER HAS BEEN A CONVENTIONAL EMPLOYER-EMPLOYEE RELATIONSHIP ONBOARD A FISHING VESSEL.

FURTHER, THE SHARE SYSTEM, HIGH CREW TURNOVER, AN OFTEN MIGRATING WORKFORCE, AND AN INDUSTRY SECTOR SUBJECT TO SUCH UNCONTROLLABLE VARIABLES AS WEATHER AND FISH MIGRATION, PROVIDES FOR WORKING CONDITIONS WHICH ARE NOT APPROPRIATE FOR CONVENTIONAL SOCIAL ANALYSIS.

HENCE, IN THE FISHING VESSEL SECTOR IT IS DIFFICULT TO DEFINE SUCH ISSUES AS "LACK-OF-WORK" OR OTHER SITUATIONS WHERE CONVENTIONAL ANALYSIS MAY JUSTIFY UNEMPLOYMENT COMPENSATION.

WE HAVE, IN FACT, ALSO RE-POSITIONED THE EXEMPTION TO RECOGNIZE THE GROWTH THAT HAS OCCURRED IN THE VESSEL SECTOR. MOST FISHING VESSELS ARE NOW OVER 10 NET TONS, BUT DO NORMALLY CARRY A CREW OF LESS THAN 10 FISHERMEN. ACCORDINGLY, WE HAVE PROPERLY RE-FOCUSED THIS EXEMPTION.

IN ADDITION TO THE ABOVE, WE HAVE MORE CONSISTENTLY CODIFIED THE TAX LAW, AND REMOVED AN ECONOMIC BURDEN WHICH WAS NOT WIDELY USED.

IN ADDRESSING THE MATTER OF LOST BENEFITS FOR CREWMEMBERS, WE NOW HAVE A TWO YEAR WINDOW WHICH WE CAN REVIEW. FIRST, PRIOR TO 1981 VERY FEW CREWMEMBERS ACTUALLY APPLIED FOR UNEMPLOYMENT, AND SECOND, DURING THE IMMEDIATE PAST TWO YEARS OF THE EXEMPTION, PRACTICALLY NO CREWMEMBERS HAVE VOICED THE NEED FOR UNEMPLOYMENT COMPENSATION.

IN FACT, THIS EXEMPTION HAS HELPED TO KEEP BOATS AND CREWS PRODUCTIVE, AND CURTAILED MINOR MISUSE OF THE LAW.

IN SUMMARY, WE NEED THIS CONTINUANCE, WE CONFIRM ITS BENEFITS AND HONESTLY BELIEVE LITTLE HAS BEEN LOST BY ITS EXISTENCE.

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WITH REGARD TO THE FULL 10 PERCENT TAX CREDIT ON FISHING VESSELS AND RELATED EQUIPMENT FUNDED BY CAPITAL CONSTRUCTION FUND WITHDRAWALS, WE URGE THAT THIS ISSUE BE PASSED INTO LAW.

HISTORICALLY, THE CAPITAL CONSTRUCTION FUND AND THE INVESTMENT TAX CREDIT HAVE BEEN CONSIDERABLE FACTORS IN THE MODERNIZATION AND EXPANSION OF OUR FISHING FLEET. IN NEW ENGLAND, OUR TRAWL FLEET INCREASED BY A FACTOR OF 50 PERCENT FROM 1976 TO 1981. THE INVESTMENT TAX CREDIT AND CAPITAL CONSTRUCTION FUND WERE INFLUENTIAL FACTORS IN THIS GROWTH.

ALTHOUGH THIS GROWTH HAS SLOWED, THERE ARE THREE FACTORS PRESENT WHICH MANIFEST A CLEAR NEED FOR CAPITAL INVESTMENT INDUCEMENTS. IN THE NEXT 5 TO 10 YEARS WE NEED TO ADDRESS MATTERS OF HARVEST EFFICIENCY, HARVESTING TECHNOLOGY, AND PRODUCT QUALITY: ALL CLOSELY RELATED ISSUES.

EVEN THOUGH HYPER-INFLATION HAS ABATED, VESSEL CAPITAL COSTS AND OPERATIONAL COSTS CONTINUE TO INCREASE SIGNIFICANTLY. THIS TENDS TO DEPRESS PROFITS AND HAVE A COST-PUSH EFFECT ON PRICES, THE RESULT BEING HIGHER PRICES TO THE CONSUMER AND A RETARDANT EFFECT ON CONSUMPTION.

SECONDLY, THE FISHING INDUSTRY HAS BEEN LESS THAN PROGRESSIVE IN CREATING AND PUTTING NEW TECHNOLOGY IN PLACE.

THIRD, PRODUCT QUALITY HAS REMAINED SOMEWHAT STATIC IN THE PAST YEARS.

THERE ARE, THEN, OBVIOUS NEEDS TO PUT CAPITAL EQUIPMENT IN PLACE WHICH WILL REDUCE VESSEL CAPITAL AND OPERATIONAL COSTS, HELP VESSELS EMBRACE NEW TECHNOLOGY IN NAVIGATIONAL ELECTRONICS, COMPUTERS, MORE EFFICIENT HARVESTING GEAR, AND MORE EFFICIENT PROPULSION SYSTEMS, AND JUST AS IMPORTANT, PUT TECHNOLOGY IN PLACE WHICH WILL ENHANCE PRODUCT QUALITY.

HENCE, THERE IS A NEED OF THE GREATEST MAGNITUDE TO CREATE EFFICIENCES AND TECHNOLOGIES WHICH WILL REDUCE COSTS, ENHANCE PROFITS, AND REDUCE OR AT LEAST SLOW THE GROWTH IN PRICING. THESE WILL RESULT IN LOWER CONSUMER PRICES, INCREASED CONSUMPTION DOMESTICALLY AND INCREASED OPPORTUNITY FOR EXPORT OF FISHERIES PRODUCTS.

THE CAPITAL CONSTRUCTION FUND AND THE INVESTMENT TAX CREDIT ARE FINANCIAL TOOLS OF THE HIGHEST IMPORT IN HELPING TO ACHIEVE NEEDED ADVANCEMENTS.

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WE ALSO ENDORSE THE EMPLACEMENT OF THE ENERGY TAX CREDIT FOR CERTAIN FISHING VESSEL FUEL SAVING DEVICES.

PRESENTLY, FISHING VESSELS ARE HIGHLY FUEL DEPENDENT. FUEL MAY REPRESENT FROM 10 PERCENT TO 20 PERCENT OF A FISHING VESSEL'S REVENUE. ACCORDINGLY, INCREASES OR DECREASES IN FUEL CONSUMPTION AND PRICING HAVE A HIGH LEVERAGE EFFECT ON VESSEL RESULTS.

FURTHER, UNDER COMMON FISHING VESSEL LAY SYSTEMS, PART OR ALL OF THE FUEL MAY BE CONSIDERED A CREW EXPENSE.

ACCORDINGLY, AN ENERGY TAX CREDIT GIVES VESSEL OWNERS AN INDUCEMENT TO PUT FUEL SAVING DEVICES IN PLACE, THEREBY HELPING TO REDUCE OPERATING COSTS, ADD TO HARVEST EFFICIENCY, AND INCREASE THE NET BENEFITS PAID TO CREWMEN.

BOTH THE NEED AND THE REQUISITE TECHNOLOGY ARE PRESENT. THIS ENERGY TAX SHOULD BE AN ECONOMIC CATALYST IN REDUCING THE OVERALL IMPACT AND DEPENDENCE ON FUEL VAGARIES.

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IN SUMMARY, WE HAVE BEFORE US THREE OPPORTUNITIES WHICH CAN SIGNIFICANTLY HELP THE EFFICIENCY AND PRODUCTIVITY WITH WHICH THE FISHERIES HARVEST PROCESS IS CARRIED OUT. WE ENDORSE THESE ISSUES, AND URGE YOU TO EMBRACE AND IMPLEMENT THEM. THANK YOU.

**STATEMENT OF WILMA ANDERSON, DIRECTOR, ACCOMPANIED BY KRISTIN VEHRS, WASHINGTON REPRESENTATIVE, TEXAS SHRIMP ASSOCIATION, AUSTIN, TEX.**

Ms. ANDERSON. Thank you, Mr. Chairman, and Senator Mitchell, for the opportunity to be included in this hearing today.

My name is Wilma Anderson, and I am from Aransas Pass, Tex. I own three vessels that commercially fish in the Gulf of Mexico for shrimp. I am also a director of the Texas Shrimp Association.

The three bills—S. 1768, 1332, and S. 146—are of the utmost importance to the shrimp industry, as also to all the other fisheries. My comments will be directed more to S. 146, "Permanent Exemption from FUTA Tax for Wages of Certain Fishing Boat Crew Members."

My statement filed includes a brief on the employment of crews, time elements and costs involved in reporting and amending the reports, present reporting and amending procedures, the experience rates, tax status, and estimated cost to the Texas fleet under the State and Federal unemployment.

S. 146 would provide tremendous savings to the vessel owners in tax dollars retained and accounting costs that would be saved. We feel that the FUTA tax should hold the same exemption for self-employed fishermen as social security and withholding taxes do under the present 1976 Tax Reform Act.

Regarding Mr. Davidson's statement, the industry in Texas—as well as in the other coastal States for shrimping—has tremendous crew turnovers. My testimony shows that a vessel that holds a crew of 3, sometimes will have 14 different crewmembers on that vessel for the year. Thus, the employer is being assessed on that much turnover and total crew wage. It would be a savings to us; it would save us tremendous paperwork; and we think it should hold the permanent exemption.

All of the vessel owners in our area support this bill and would like to see a total exempt, become law as we have for the FICA and the withholding.

I would be happy to answer any questions, if anyone has any.

[Ms. Anderson's prepared statement and Ms. Vehrs' prepared statement follow:]

STATEMENT OF

WILMA L. ANDERSON

PRESIDENT
OCEAN BREEZE

ON

S. 146

BEFORE

THE SENATE SUBCOMMITTEE ON TAXATION

AND DEBT MANAGEMENT

MARCH 16, 1984

CREWS

Crews on the vessels are transit employees moving constantly from one vessel to another. The Captain is normally a permanent employee throughout the year and in some instances he may have a co-worker (rigman) that will work the entire year, this would possibly occur in one out of ten rigmen.

As self-employed fishermen they are responsible for their own income tax and fica tax. In order for a crew member to draw on state and/or federal unemployment, they must show proof that they have filed a current year 1020 tax return (filing date 2/15). There is a high delinquency in filing this return, therefore, they are unable to draw benefits until the return is filed and in order, by this time the slow months of the winter season (February, March & April) are over and the spring shrimp season begins and the employees return to work and the claims filed become unserviceable by the commission. These tax dollars expended by the employing unit into the fund remains unused by those employees the employing unit is paying benefits for.

I feel that the Captain is the primary employee of the employing unit, his income is substantial to carry him during the slow months, and normally if production is sufficient his employment along with the other crew members will remain constant for the entire year.

## TIME ELEMENTS AND COSTS INVOLVED IN REPORTING AND AMENDING REPORTS

Under the present system it is very costly in time, money and personnel for the employer, state and federal agencies, because of the duplicating work involved in reporting and amending tax reports.

PROCEDURE 1 - REPORTING:

(a) Employer must file state quarterly reports, deposit quarterly for FUTA and file Form 940 for the year.

(b) State must record earnings per individual listed on the quarterly reports and also record under the I. D. number of the employer and note if reports and taxes are filed current or delinquent, if delinquent, penalty and interest must be levied against the employer and collected.

(c) Federal must record quarterly deposits under the I. D. number of the employer, Form 940 must be recorded for the employer and noted as current or delinquent on filing and timely deposits per quarter according to the report, if delinquent on quarterly deposits and report, penalty and interest must be levied against the employer and collected.

PROCEDURE 2 - AMENDING:

(a) In order for the employer to receive a refund on taxes paid in error, he must file amended state quarterly reports and cover sheet for the four quarters of amount of tax paid in error to the state and amended Form 940 to federal for refund of tax paid in error for FUTA.

* (b) State must record and reverse the amended report on individual earnings per quarter and refund taxes paid in error for the year.

* (c) Federal must record the amended Form 940 report and refund taxes paid in error for the year.

* Accrued interest must be calculated by state and federal on the overpayment of taxes.

By eliminating Procedure 1 and 2 under a permanent exemption would be a tremendous savings to the U. S. Taxpayer and the employing unit.

## TAX REPORTING UNDER PRESENT LAW

STATE REPORTING QUARTERLY:

| | |
|---|---|
| 3/31 | Form C-3 |
| 6/30 | Form C-3 |
| 9/30 | Form C-3 |
| 12/31 | Form C-3 |

FUTA REPORTING:

| | |
|---|---|
| | Deposit for FUTA if tax exceeds 100.00 for the quarter. |
| 3/31 | Deposit |
| 6/30 | Deposit |
| 9/30 | Deposit |
| 12/31 | Deposit |
| 12/31 | Form 940 |

## AMENDING TAX REPORTS UNDER TEMPORARY EXEMPTION

### 1981 AND 1982

Form C-5 Wage List Adjustment Schedule
Form C-7 Adjustment Report to Correct Amounts of Taxable and/or Total "Wages" Reported on Employer's Quarterly Report, Form C-3, Previously Filed.
Form C-67 Application for Refund of Amounts Paid in Error

AMENDING STATE REPORTING QUARTERLY:

| | |
|---|---|
| 3/31 | Form C-5 and C-7 |
| 6/30 | Form C-5 and C-7 |
| 9/30 | Form C-5 and C-7 |
| 12/31 | Form C-5 and C-7 |
| 12/31 | Form C-67 Cover Sheet for the four quarters above. |

FUTA AMENDED RETURN:

| | |
|---|---|
| 12/31 | Form 940 amended for refund of amount paid in error and reported. |

FORM C-67 (5/78)

# TEXAS EMPLOYMENT COMMISSION

AUSTIN, TEXAS 78778

## APPLICATION FOR REFUND OF AMOUNTS PAID IN ERROR

| NAME, ADDRESS AND ACCOUNT NUMBER OF EMPLOYING UNIT MAKING APPLICATION FOR REFUND. | **APPLICATION MUST BE FILED IN TRIPLICATE**<br>If the refund requested covers overpayment for which you have been notified, file **only** refund applications. If not, attach adjustment reports, Forms C-5 for each quarter affected by this application. If individual employees on the payroll detail for any of these quarters are affected, Wages List Adjustment Schedule, Forms C-7, showing the individual wage adjustments to be made must also be attached. | APPLICATION NO.<br>PAID BY: CASH WARRANT<br>CREDIT MEMO |
|---|---|---|

**VENDOR IDENTIFICATION NUMBER** _____

*(Please see instructions on back)*

_____ states that he is _____ of the above named employing unit; that the employing unit is: 1-A CORPORATION ( ); 2-A PARTNERSHIP ( ); 3-AN INDIVIDUAL ( ); 4-OTHER _____; that in behalf of such employing unit, reports were filed and payments remitted which are now determined to be in error resulting in over payment of contribution and/or penalty as follows:

**SUMMARY OF WAGES OVER-REPORTED AND AMOUNTS OVERPAID**

| YEAR | QUARTER ENDING | TAXABLE WAGES OVER-REPORTED | TAXES | PENALTY 14(a) | PENALTY 14(c)(1) | LEAVE BLANK |
|---|---|---|---|---|---|---|
| | MARCH 31 | COVER SHEET FOR FOUR QUARTER ADJUSTMENT OF OVERPAYMENT | | | | |
| | JUNE 30 | | | | | |
| | SEPTEMBER 30 | | | | | |
| | DECEMBER 31 | | | | | |
| | MARCH 31 | | | | | |
| | JUNE 30 | | | | | |
| | SEPTEMBER 30 | | | | | |
| | DECEMBER 31 | | | | | |
| | MARCH 31 | | | | | |
| | JUNE 30 | | | | | |
| | SEPTEMBER 30 | | | | | |
| | DECEMBER 31 | | | | | |
| | MARCH 31 | | | | | |
| | JUNE 30 | | | | | |
| | SEPTEMBER 30 | | | | | |
| | DECEMBER 31 | | | | | |
| TOTAL REFUND REQUESTED--- | | | TOTAL TAX $ | | TOTAL PENALTY $ | |

THAT THE REMITTANCES WERE IN ERROR AS SHOWN, DUE TO THE FOLLOWING REASON. RECOVERY ACT FOR SELF-EMPLOYED FISHERMEN

DUE TO THE FACT THE REMITTANCES, AS MADE, WERE IN ERROR, CLAIM IS NOW BEING MADE FOR REFUND IN THE AMOUNT OF $ _____, AND THAT SUCH REQUEST FOR REFUND IS MADE IN ACCORDANCE WITH SECTION 14(J) OF THE TEXAS UNEMPLOYMENT COMPENSATION ACT, AND THAT THE STATEMENTS AND SCHEDULES CONTAINED HEREIN, AS WELL AS ANY ACCOMPANYING STATEMENTS AND SCHEDULES RELATIVE HERETO, ARE TRUE AND CORRECT.

**SIGNED** _____ **TITLE** _____ **DATE** _____

(SIGNATURE AND TITLE - OWNER, PARTNER, PRESIDENT, ETC.)

Must be signed by owner, partner, officer of corporation, or by person for whom a Power of Attorney has been filed with this Commission.

**DO NOT WRITE BELOW THIS LINE**

| EMP. STATUS SECTION | EMP. ACCTS. SECTION | APPROVAL | |
|---|---|---|---|
| OK: BY _____ | OK. BY _____ | BY _____ | D. M. NO. _____ |

C-7 (1175)

# TEXAS EMPLOYMENT COMMISSION

AUSTIN, TEXAS

## Wages List Adjustment Schedule

(To Correct Information Previously Filed on Form C-4)

Page Number_____
of_____Pages
For this Quarter

| Employer's Account Number, Name and Address | If the Social Security Account number, name or wages of one or more employees were omitted from or erroneously reported on a Wages List, each such error should be corrected on this form. If any correction or adjustment needs more explanation than is provided by this form, simply write additional information under the item in question. SEE REVERSE SIDE FOR INSTRUCTIONS. | Audited By<br>Reference |
|---|---|---|

Adjustments for
(1) the Quarter ending _____ 19__

| Employee's S.S. (1) Account Number | (2) EMPLOYEE'S NAME | (3) BENEFIT WAGE CREDITS As Reported | (4) Corrected | (5) Page No. Original Report | (6) TAXABLE WAGES As Reported | (7) Corrected | Leave Blank |
|---|---|---|---|---|---|---|---|
| | | ✓ | | | ✓ | | |
| | | | | | | | |
| | PER QUARTER - MUST CORRESPOND WITH QUARTERLY REPORT FILED. | | | | | | |
| | | | | | | | |
| | | | | | | | |
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| | | | | | | | |
| | | | | | | | |
| TOTALS | | | | XXXXX | | | |
| DIFFERENCE BETWEEN TOTALS | | XXXXXXXX | ✓ | XXXXX | XXXXXXXX | ✓ | |

I certify that the above information is true and correct.

Signed_____ Title_____ Date_____ 19____

ADP: Original Wage Credits Verified By _____ Date_____ 19____

Corrected Cards Punched and Balanced By_____; Refiled By_____ Date_____ 19____

A SEPARATE FORM MUST BE FILED FOR EACH QUARTER BEING CORRECTED.
LIST ONLY THE DATA FOR WHICH CORRECTIONS ARE REQUIRED

EXAMPLES TO CORRECT DATA PREVIOUSLY REPORTED OR OMITTED

| Employee's S.S. Account Number (1) | (2) EMPLOYEE'S NAME | (3) BENEFIT WAGE CREDITS As Reported | (4) BENEFIT WAGE CREDITS Corrected | (5) Page No. Original Report | (6) TAXABLE WAGES As Reported | (7) TAXABLE WAGES Corrected | Leave Blank |
|---|---|---|---|---|---|---|---|

The following example illustrates the proper method to report either omitted Social Security Account Number(s) or Wage Amount(s). The Benefit Wage Credits, As Reported, Column (3) will be –0– as no wages were credited to the employee(s) earning record due to the omitted Social Security Account Number or wage amount.

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 123 | 45 | 6789 | John Doe | –0– | $1,000.00 | 2 | | |

The following example illustrates the proper method to correct the amount of wages previously reported for John Doe.

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 123 | 45 | 6789 | John Doe | $1,000.00 | $1,200.00 | 2 | | |

The following example illustrates the proper method to correct wages erroneously reported for James Doe instead of John Doe.

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 123 | 45 | 6789 | James Doe | $1,000.00 | –0– | 2 | | |
| 123 | 45 | 6789 | John Doe | –0– | $1,000.00 | | | |

The following example illustrates the proper method to correct the reporting of an erroneous Social Security Account Number.

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 123 | 54 | 6789 | John Doe | $1,000.00 | –0– | 2 | | |
| 123 | 45 | 6789 | John Doe | –0– | $1,000.00 | | | |

Form C-4 (5-73)

TEXAS EMPLOYMENT COMMISSION
AUSTIN, TEXAS 78778

# ADJUSTMENT REPORT

**To Correct Amounts of Taxable and/or Total "Wages" Reported on Employer's Quarterly Report, Form C-3, Previously Filed.**

1. Employer's Account Number, Name and Address

2. Adjustment for the Quarter Ended _____ 19____

Note—This adjustment report shall be used only for the purpose of adjusting a quarterly report previously filed and which has been found to be in error with respect to wages reported. A separate report is required for each calendar quarter to be adjusted.

If this adjustment report indicates an underpayment, attach remittance for the additional amount due. If over-payment has been made, credit for such over-payment will be issued.

Leave Blank
Audited by:
Batch No.
Credit Memo Issued: Journal Entry Made:
No.: _____
To: _____

| ITEMS | A Amounts as Originally Reported on Form C-3 for this Quarter | | | B Correct Amounts | | | C Differences: Over- or Under-reported | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1st Mo. | 2nd Mo. | 3rd Mo. | 1st Mo. | 2nd Mo. | 3rd Mo. | 1st Mo. | 2nd Mo. | 3rd Mo. |
| 3. Number of Employees (By Months) | | | | | | | | | |
| 5. Total Wages Paid | $ ✓ | | | $ | | | $ ✓ | | |
| 7. Net Taxable Wages | $ | | | $ | | | $ | | |
| 8. Contribution | at ___% : $ | | | at ___% : $ | | | at ___% : $ | | |
| 9. Penalty (Sec.14(a)) | at ___% : $ | | | at ___% : $ | | | at ___% : $ | | |
| 11. Total for this quarter | $ | | | $ | | | $ | | |

11a. If the above shows an UNDER payment of Contribution, compute additional penalty at 1% for each month from the month in which original payment was made ..... $ _____

13. TOTAL ADDITIONAL AMOUNT DUE FOR THIS QUARTER ..... $ _____

13a. If the above shows an OVER payment, enter the amount of credit requested for the Quarter ..... $ ✓

PER QUARTER - COVER SHEET FOR WAGE LIST ADJUSTMENTS AND OVERPAYMENT OF TAX

**IMPORTANT**

**Indicate reason for adjustment** RECOVERY ACT FOR SELF-EMPLOYED FISHERMEN

**If amounts reported on Form C-4 for any individual employee(s) are affected by the adjustment for this quarter, attach a Wages List Adjustment Schedule, Form C-7, showing adjustments of "benefit wage credits" (if any) and adjustments of taxable "wages" for each individual involved.**

I certify that all information contained in this Adjustment Report is true and correct.

Signed: _____ Title: _____ Date: _____

## EXPERIENCE RATE

Experience rate is set by the State Employment Commission and normally based on the number of claims filed against the corporation from prior years. Due to economics experience rates are being adjusted upward to replenish an exhausted state fund. Maximum state rate that can be assessed is 2.7% the following is an example of what is happening to our experience rates even though the employees are not drawing against the account:

1982 Taxable Wage $6,000

| | | |
|---|---|---|
| 3/31/82 | 0.5% | Exp. Rate |
| 6/30/82 | 0.5% | |
| 9/30/82 | 0.5% | |
| 12/31/82 | 0.8% | |

1983 Taxable Wage $7,000

| | | |
|---|---|---|
| 3/31/83 | 1.65% | Exp. Rate |
| 6/30/83 | 1.65% | |
| 9/30/83 | 1.65% | |

The low experience rate in 1982 reflects four (4) claims filed over a period of five (5) years prior, out of twenty-nine (29) employees two claims were filed in 1982 that affected the rate for 1983. The increase in rate did not come from the two (2) claims filed, but due to an exhausted state fund.

ESTIMATED COST TO THE TEXAS FLEET

TEC & FUTA

| | | | | |
|---|---|---|---|---|
| USING AN OVERALL AVERAGE PER VESSEL GROSS SALES | | | | $ 190,000 |
| GROSS EARNINGS CREW @ 30% | | | | $ 57,000 |
| CAPTAIN | 55% | (57,000 - 8,000 = 49,000) | 26,950 | |
| RIGMAN | 45% | " | 22,050 | |
| HEADER | 20.00 box @ 400 boxes | | 8,000 | |
| | | | 57,000 | |
| GROSS EARNINGS $ 57,000 | EXEMPT. 19,950 | TAXABLE WAGE | | $ 7,000 |
| | | | | $ 22,050 |
| | | | | $ 8,000 |
| | | | | $ 37,050 |
| STATE @ 2.7% | | 1,000.35 | | |
| FUTA @ .007% | | 259.35 | | |
| | | 1,259.70 | | |
| 1500 Vessels @ 1,000.35 | State | | | $ 1,500,525 |
| 1500 Vessels @ 259.35 | Federal | | | $ 389,025 |
| | | | | $ 1,889,550 |
| EXPERIENCE RATE @ 1.65% | | 611.32 | | |
| FUTA @ .007% | | 259.35 | | |
| | | 870.67 | | |
| 1500 Vessels @ 611.32 | State | | | $ 916,980 |
| 1500 Vessels @ 259.35 | Federal | | | $ 389,025 |
| | | | | $ 1,306,005 |

Tremendous savings to the employing units verses the small amount of benefits derived by the employing unit employees, under a permanent exemption of state and federal unemployment taxes.

## TAX STATUS

1982 and 1983 are low productive years and wages are on the decline, payroll for the two (2) vessel corporation under normal productive years would average $115,000 gross earnings.

| | | | |
|---|---|---|---|
| 1982 TAXABLE WAGE | | | 60,220.84 |
| STATE MAXIMUM @ 2.7% | | 1,625.96 | |
| FUTA @ .007% | | 421.54 | |
| | | 2,047.50 | |
| Per Vessel Tax ..... | 1,023.75 | | |
| STATE EXPERIENCE RATE 0.5% | | 301.10 | |
| FUTA @ .007% | | 421.54 | |
| | | 722.64 | |
| Per Vessel Tax ..... | 361.32 | | |
| 1983 TAXABLE WAGE (Increase to $7,000) | | | 64,314.04 |
| STATE MAXIMUM @ 2.7% | | 1,736.48 | |
| FUTA @ .007% | | 450.19 | |
| | | 2,186.67 | |
| Per Vessel Tax ..... | 1,093.34 | | |
| STATE EXPERIENCE RATE 1.65% | | 1,061.18 | |
| FUTA .007% | | 450.19 | |
| | | 1,511.37 | |
| Per Vessel Tax ..... | 755.69 | | |

TWO (2) VESSEL CORPORATION

EXAMPLE - 1982 ACTUAL YEARLY EARNINGS

| S. S. & NAME: | GROSS: | (Excess of $6,000) EXEMPTION: | TAXABLE WAGE: |
|---|---|---|---|
| CREW MEMBER | 776.91 | | 776.91 |
| MECHANIC | 9,404.48 | 3,404.48 | 6,000.00 |
| CREW MEMBER | 1,506.48 | | 1,506.48 |
| CREW MEMBER | 1,814.00 | | 1,814.00 |
| CREW MEMBER | 208.33 | | 208.33 |
| CREW MEMBER | 1,567.75 | | 1,567.75 |
| CREW MEMBER | 312.80 | | 312.80 |
| CREW MEMBER | 75.00 | | 75.00 |
| CAPTAIN | 2,332.98 | | 2,332.98 |
| CREW MEMBER | 4,129.91 | | 4,129.91 |
| CREW MEMBER | 926.43 | | 926.43 |
| CREW MEMBER | 11,427.01 | 5,427.01 | 6,000.00 |
| CREW MEMBER | 1,597.67 | | 1,597.67 |
| CREW MEMBER | 372.50 | | 372.50 |
| CAPTAIN | 6,093.20 | 93.20 | 6,000.00 |
| CREW MEMBER | 360.70 | | 360.70 |
| CREW MEMBER | 25.00 | | 25.00 |
| CREW MEMBER | 1,681.16 | | 1,681.16 |
| CREW MEMBER | 776.90 | | 776.90 |
| CREW MEMBER | 285.30 | | 285.30 |
| CREW MEMBER | 456.00 | | 456.00 |
| CAPTAIN | 5,421.68 | | 5,421.68 |
| CREW MEMBER | 1,750.00 | | 1,750.00 |
| CREW MEMBER | 265.00 | | 265.00 |
| CREW MEMBER | 998.17 | | 998.17 |
| CREW MEMBER | 1,938.55 | | 1,938.55 |
| CREW MEMBER | 7,283.01 | 1,283.01 | 6,000.00 |
| CREW MEMBER | 641.62 | | 641.62 |
| CAPTAIN | 25,446.46 | 19,446.46 | 6,000.00 |
| | 89,875.00 | 29,654.16 | |

1982 TAXABLE WAGE STATE AND FEDERAL ..... 60,220.84

28 Employees (Mechanic excluded) - Vessel carries a crew of 3 employees. The two (2) vessels above reflect 14 employees per vessel during the year.

STATEMENT OF

KRISTIN L. VEHRS

WASHINGTON REPRESENTATIVE
TEXAS SHRIMP ASSOCIATION

ON

S. 1768, S. 1332 AND S. 146

BEFORE

THE SENATE SUBCOMMITTEE ON TAXATION

AND DEBT MANAGEMENT

MARCH 16, 1984

Mr. Chairman and Members of the Subcommittee my name is Kristin Vehrs. I am the Washington Representative of the Texas Shrimp Association. We appreciate the opportunity to address this Subcommittee on three (3) different bills -- Fishing Energy Tax Credits Act, Capital Construction Fund Amendment and the Federal Unemployment Tax Act. The first two bills would assist the industry in making new investments and increase the incentive to keep the industry efficient with state-of-the-art equipment. The third bill, the Federal Unemployment Tax Act, is of utmost importance to the Texas Shrimp Association. We support these bills.

The Texas Shrimp Association is a trade association representing shrimp harvesters residing in Texas as well as most of the other Gulf of Mexico coastal states. Currently, this membership consists of individuals who control approximately 420 Gulf class shrimp vessels and 100 support and service corporations. The shrimp industry of this nation continues to be its most valuable fishery.

First, I will address H.R. 1768, the energy tax credit legislation. Since 1979 when diesel fuel prices rose from 40¢ to $1.00 plus a gallon, the shrimp industry has been very concerned with energy conservation. Fuel costs are still the single largest operating cost of a shrimp vessel. There have been a number of studies conducted since 1979 on energy saving devices in the shrimp industry. I believe most of these devices are included in the list of qualified harvesting equipment in H.R. 1768 -- fuel flow meter, hull speed meter, propeller thrust nozzle, variable pitch or two-speed propeller, diesel fuel preheater and Loran C, etc.

I would suggest the addition of a turbocharger which is a turbine compressor driven by hot exhaust gasses that provide additional air to the engine's cylinders. That permits a larger fuel charge to be burned in the cylinder, allowing the engine to develop more horsepower without increasing the engine size. The result is a more efficient engine and a reduction in fuel consumption.

The addition of these energy savers is an important step in keeping the fleet current with the state-of-the art. In particular, there have been few new vessels in the fleet since 1979 because of rough times in the industry. Therefore, updating the existing fleet to maximize the fuel efficiency of the vessels is even more important. A 10% investment tax credit would be a valuable incentive because many of these devices have an initial cost of several thousand dollars. We would urge the Subcommittee to favorably report out S. 1768.

Next, I will briefly comment on H.R. 1332, an amendment to the capital construction fund (CCF) which would permit participants to take a full 10% investment tax credit. At present, the Tax Reform Act of 1976 only permits an investment tax credit of 5% on qualified expenditures made from tax-deferred amounts in a CCF. It has never been clear whether the other 5% could be claimed or not and there have been a number of challenges in the Courts on this very issue. The ability to take the full investment tax credit would be a further inducement to set aside monies in a CCF and would clarify the present uncertainty in the law. We would request the Subcommittee's support of this bill.

Finally, I will address S. 146, the permanent exemption of crewmen on shrimp vessels from federal unemployment taxation. Passage of this legislation is slated as a high priority by the TSA Board of Directors. An exemption from federal unemployment tax would also mean that Texas state unemployment would not have to be paid.

Commercial fishermen are considered to be self-employed, independent contractors. They are not paid a fixed salary but are paid a share of the catch or proceeds from the catch. The crews of the vessels in this way maintain their independence. In addition, there is frequent turnover in crews. Many vessel owners consider themselves lucky to have the same crew for more than one trip. Because of this large turnover, record-keeping can be an absolute nightmare.

In 1976, the Tax Reform Act found that owners of fishing vessels manned by a share paid crew of 10 or less were exempted from withholding federal income taxes and social security taxes on their crewmembers. We believe that an exemption from the payment of Federal unemployment tax was also intended but overlooked.

In 1981 and 1982 respectively, there was a one-year exemption from Federal unemployment tax. TSA urges that a permanent Federal unemployment tax exemption would simply make the unemployment law consistent with the rest of the tax code, treating crews as independent contractors for all purposes. This permanent exemption would take away the uncertainty that presently exists on a year-to-year basis. We urge the Subcommittee to favorably report S. 146.

Once again, TSA thanks the Subcommittee for the opportunity to address these three bills. I would be pleased to address any questions the Subcommittee may have.

**STATEMENT OF ELDON GREENBERG, ESQ., GALLOWAY & GREENBERG, WASHINGTON, D.C., ON BEHALF OF THE SOUTHEASTERN FISHERIES ASSOCIATION, TALLAHASSEE, FLA.**

Mr. GREENBERG. Chairman Packwood, Senator Mitchell, I am Eldon Greenberg, representing Southeastern Fisheries Association. We are the largest commercial fishing association in the Southeastern United States, with approximately 400 members, and we are pleased to appear today to support all three pieces of legislation before the subcommittees.

I want to focus on the tax credit legislation; but before I do, let me just emphasize, along with others here this morning, that there seems to be a consensus—as reflected in congressional action in 1981 and 1982—on the need to exempt small vessels with small share-paid crews from FUTA, Rather than debating this issue every year and creating substantial uncertainty in the industry, we believe Congress should act once and for all and make this exemption permanent.

Now, with respect to S. 1332, that seems to us to be a very desirable piece of legislation. It would clarify the law and make it clear that the full investment tax credit is recoverable, even when CCF funds are invested in new vessels.

As you know, Congress left this question open in 1976 when it passed the 1976 Tax Reform Act. But the Court of Claims has consistently held that the credit is available without regard to the nature of the funds invested. We have attached to our statement a list of all of those cases in which the Court of Claims has held that the full investment tax credit is available even when CCF funds are invested.

Nonetheless, as a practical matter, in order to get the full investment tax credit, the fisherman is forced to go to court to litigate each and every case. That is obviously burdensome and time consuming, and we think Congress should lift that burden by clarifying the law and explicitly adopting the Court of Claims consistent interpretation.

As to S. 1768, that bill would encourage investment in energy-saving equipment in the harvesting sector. We have attached to our written statement an extensive study prepared for the Gulf and South Atlantic Fisheries Development Foundation, which indicates that this equipment has real benefits, particularly for the gulf shrimp fleet.

In the gulf shrimp fleet, as much as 54 percent of operating costs may be devoted to fuel, and if we can get people to invest in energy saving equipment, we can create a more efficient industry which will be a benefit to the consumers throughout the United States as well as for the profitability of the fleet.

Senator MITCHELL. What was that percentage? Fifty?

Mr. GREENBERG. About 54 percent of the operating costs in the gulf shrimp fleet involve the purchase of fuel.

In sum, Senator Packwood and Senator Mitchell, all of this legislation is highly desirable, and we urge the subcommittees to take positive action

Thank you.

Senator PACKWOOD. Thank you very much.

[Mr. Greenberg's prepared statement follows:]

STATEMENT OF

THE SOUTHEASTERN FISHERIES ASSOCIATION, INC.

WITH RESPECT TO S.146, S.1332 and S. 1768 BEFORE

THE SUBCOMMITTEES ON TAXATION AND DEBT MANAGEMENT

AND ENERGY AND AGRICULTURAL TAXATION

OF THE SENATE FINANCE COMMITTEE

March 16, 1984

Eldon V.C. Greenberg
Galloway & Greenberg
1725 Eye Street, N.W.
Suite 601
Washington, D.C. 20006
(202) 833-9084

Counsel to
Southeastern Fisheries
Association, Inc.

The Southeastern Fisheries Association, Inc. ("SFA") 1/ wishes to express its strong support for three bills, S.146, S.1332 and S.1768, which are currently pending before the Subcommittee: the first of these bills is of critical importance to the commercial fishing industry in the southeastern United States, while the other two bills, which would significantly assist the industry in making new investments and thereby increase the overall efficiency of our fishing operations, are highly desirable.

(1) S.146

S.146 would make permanent provisions adopted by the Congress for the years 1981 and 1982 which exempted the owners of fishing vessels manned by a share-paid crew of ten or less from paying unemployment taxes on crew members. In enacting this exemption for the years 1981 and 1982, Congress corrected an oversight in the Tax Reform Act of 1976 and made the treatment of crew members for purposes of the Federal Unemployment Tax Act ("FUTA") consistent with the treatment of crew members for purposes of withholding social security ("FICA") taxes and Federal income taxes. There is every reason to make this correction permanent.

1/ SFA, which is headquartered in Tallahassee, Florida, is the largest commercial fisheries trade association in the southeastern United States. It has more than four hundred members from all sectors of the commercial fishing industry from North Carolina to Texas. SFA's address and telephone number are:

Southeastern Fisheries Association, Inc.
312 East Georgia Street
Tallahassee, Florida 32301
(904) 224-0612

In enacting the Tax Reform Act of 1976, and in recognizing that crewmen on fishing vessels should be considered as self-employed, rather than employees, for purposes of FICA and Federal income tax withholding, Congress simply responded to the realities of the fishing industry. Crew members ordinarily do not receive a fixed salary, but rather simply receive a share of the catch or proceeds from the catch. Thus, they have no steady income stream as ordinary employees. Crew members, particularly on smaller vessels, are basically independent contractors, often hired at the last minute for a particular voyage, who, after that voyage is over, share in the profits and then move on to other work. Indeed, crew members often take the same risk as owners, for if there is no catch, there are no proceeds to share and, therefore, no payment for the work performed.

The frequent turnover in crews also means that there is no steady work force on a particular boat. This turnover, coupled with the informal nature of the arrangements between vessel operators and crew, makes it difficult, if not impossible, to meet the kind of reporting requirements that are essentially designed for situations where there is a long-standing employer/employee relationship. Indeed, imposition of such requirements on the fishing industry -- an industry largely composed of small, independent businessmen with limited time to spend on paperwork -- would be extremely burdensome and perhaps unworkable.

In short, precisely the same reasons which led Congress to act in 1976 with respect to Federal income tax and FICA withholding compel the conclusion that application of FUTA makes little sense in the fishing industry. Enactment of S.146 would reflect an appropriate and realistic understanding of the nature of the fishing industry and would avoid the anomalous and confusing situation where crews would be treated as employees for some purposes and independent contractors for others.

We believe that Congress made the right judgment in enacting the FUTA exemptions for 1981 and 1982. Since Congress so acted on two occasions, with little dissent, we see no justification for Congress continuing to debate on a yearly basis the appropriateness of this action. Rather, the exemption should be made permanent, thereby alleviating, once and for all, the uncertainty which exists in the industry as to its potential liability under FUTA.

(2) S.1332

S.1332 would amend Section 46 of the Internal Revenue Code to provide that the amount of investment tax credit allowed by Section 38 of the Code may not be reduced to the extent a fishing vessel is purchased or reconstructed with withdrawals from a Capital Construction Fund ("CCF") established under Section 21 of the Merchant Marine Act of 1970. This bill appropriately recognizes sound judicial interpretation of the Code upholding the availability of

investment tax credits on vessels purchased with tax deferred or tax exempt funds, and, if enacted, will eliminate the need to resort to expensive and time consuming litigation to justify application of the investment tax credit.

Under the Tax Reform Act of 1976, for tax years after 1975, Section 46(g) of the Internal Revenue Code provides for an investment tax credit of one-half the normal investment credit on amounts withdrawn from CCF accounts. It specifically left open the questions whether the other one-half could properly be claimed and whether the credit was available at all when pre-1976 deposits are invested. H.R.Rep. No. 1515, 94th Cong., 2d Sess. 447-448 (Sept. 13, 1976). In effect, it left these issues up to the courts. Thus, there has been continued uncertainty with respect to the availability of the credit, and the Internal Revenue Service has taken the position that the full credit is not available when any CCF funds are invested, and not even the half credit could be taken when pre-1976 deposits are invested.

Since 1976 the Court of Claims, relying upon the Congressional intent to make the investment tax credit available without regard to whether the invested funds are "derived from untaxed, tax-exempt, or tax deferred income", has consistently ruled that investment tax credits cannot be denied when tax deferred funds, such as CCF funds, are used to purchase new vessels. E.g., Pacific Far East Line, Inc.

v. U.S., 544 F.2d 478 (Ct. Cl. 1976). 2/ We think the Court in Pacific Far East Line was precisely right when it stated unequivocally,

> [I]t is unthinkable that the amount of the conceptually simple investment credit was intended - without a word of textual support - to be affected by the extent of taxation or the deferral of taxation on income that had produced funds used to make the investment that creates the credit. Such a result would cause the credit to vary in an unpredictable and arbitrary amount depending on all the countless array of prior events that affected taxpayers' effective rates of taxation on income earned years before. The operation of the credit would be infinitely capricious, and the accounting difficulties in tracing funds to their source and ascertaining the extent to which they had been taxed would be staggering. Id. at 485.

Nonetheless, the Service, ignoring such judicial interpretations, has continued to maintain its position that the credit should not be available.

At this point, it seems clear that it is necessary for Congress to act to overcome the intransigence of the Revenue Service and firmly establish the principle enunciated by the Court of Claims. Only such action can end the uncertainty which currently surrounds this question and eliminate the need for vessel owners to seek judicial relief in each and every case in which they seek full investment credits on investments with CCF funds.

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2/ A listing of Court of Claims decisions as of November, 1983 is attached at Tab A.

(3) S.1768

S.1768 would amend Section 48(1) of the Internal Revenue Code to allow an energy investment credit for certain "qualified harvesting equipment" used by fishing vessels. It properly recognizes that the equipment specified will, if purchased, lead to a reduced fuel consumption and therefore should be encouraged.

There is little question that the specified "qualified harvesting equipment" has real energy saving benefits when adopted by fishing vessels. Fuel flow meters and hull speed meters allow the captain properly to gauge fuel flow and vessel speed to maximize the efficiency of operations. Propeller thrust nozzles, various sophisticated propellers, and bow or side thrusters increase maneuverability and turning ability and so reduce the time necessary to carry out fishing operations. Hull treatments and bulbous bows reduce water resistance. Onboard heat exchangers and sail equipment have obvious benefits in reducing the need to utilize oil, diesel fuel and gasoline. And automatic Loran C navigational apparatus helps ensure that a captain knows where he is, thereby eliminating unnecessary travel time to and from fishing grounds. Attached at Tab B is a recent report, "Fuel Conservation in the Gulf and the South Atlantic Shrimp Fishing Fleet", by C. David Veal and John R. Kelly, published as part of the comprehensive Assessment of Shrimp Industry Potentials and Conflicts (August 1983), sponsored by the Gulf

and South Atlantic Fisheries Development Foundation, which extensively documents these savings. 3/

All these benefits are important because fishing operations are often energy intensive. This is particularly true in the Gulf of Mexico and South Atlantic, where fuel costs in the shrimp fleet, the largest commercial fleet in the Southeast, represent a major portion of total operational expenditures. In Louisiana, for example, based on 1978 prices, fuel and oil may account for 40%-54% of operating costs of vessels over 50 feet. Veal and Kelly, supra, at VIII-1. And the Gulf fleet as a whole, again based on 1978 statistics, consumes perhaps 33% of the diesel fuel used in all U.S. fisheries. Id. Whatever the incentive effect of the energy investment credit in other sectors of the economy, it seems obvious, because of the high percentage of energy costs as a component of total fishing vessel operations, that the credit is likely to create real incentives for fishing vessel owners and operators to invest in energy saving equipment.

Adoption of all of this equipment would help to modernize the U.S. fishing fleet. Moreover, reducing fishing time should result in increasing the catch per unit of effort and ultimately producing cost savings for the consuming public. In sum, making the energy investment credit

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3/ The authors also suggest that the following technologies produce savings: two speed gear boxes, rudder modifications, external keel coolers, and shell protection rubbars or corrosion protection bars. Consideration should be given to including these in the legislation.

available for this equipment will not only help reduce U.S. dependence on imported fossil fuels, but will also help ensure that the U.S. fishing industry moves toward the goal of full utilization of our Nation's fishery resources, with maximum benefits to the consuming public.

The importance of moving toward energy efficiency in the shrimp fleet, in particular, cannot be understated. As Veal and Kelly conclude:

> If greater fuel efficiency cannot be developed through fuel management techniques and new technological innovations, a major economic upheaval can be expected in the shrimping industry; one that is likely to cause significant economic loss and hardship to fishermen and processors as well, and change the structure of the industry.

Veal and Kelly, supra, at VIII-4.

In sum, all three bills deserve the full support of Congress, and we urge the Subcommittees to take positive action on them.

Thank you for the opportunity to present our views.

Tab A

## COURT OF CLAIMS CASES UPHOLDING THE AVAILABILITY OF THE INVESTMENT TAX CREDIT

The following Court of Claims cases have resulted in a favorable determination regarding the full ten percent investment tax credit even though there was a basis reduction for depreciation purpose as a result of withdrawals from the Capital Construction Fund: 1/

Pacific Far East Lines, Inc. v. United States, 211 Ct. Cl. 71, 544 F.2d 478 (1976).

Oglebay-Norton Co. v. United States, Ct. Cl. 229-77.

Pacific Transport Co. and Subsidaries v. United States, 211 Ct. Cl. 99, 544 F.2d 493.

Delta Steamship Lines, Inc. v. United States, 214 Ct. Cl. 104, 544 F.2d 496.

O.L. Schmidt Barge Lines, Inc. v. United States, 610 F.2d 728.

Moore McCormack Resources, Inc. and Consolidated Subsidaries v. United States, 46 AFTR 2d 80-5075.

Gilman v. United States, 45 AFTR 2d 80-782 U.S. Ct. Cl. No. 234-78.

Ness v. United States, 45 AFTR 2d 80-784 U.S. Ct. Cl. No. 235-78.

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1/ There is one Tax Court decision going the other way. Peter Zaunich, 77 TC 428, No. 31.

Tab B

REPORT VIII

# Fuel Conservation in the Gulf and South Atlantic Shrimp Fishing Fleet

Contributors

C. David Veal

John R. Kelly

for

RMD, Inc.
Resource Management and Development
Biloxi, MS

Senator PACKWOOD. Ms. Vehrs, did you want to say anything?

Ms. VEHRS. No, sir. I don't think it is necessary for me to reiterate what the panel has said, other than to thank both you and Senator Mitchell for your support of these pieces of legislation, and to thank you for your efforts in getting the 2-year exemption accepted in the deficit reduction package.

Thank you.

Senator PACKWOOD. Thank you.

George, any questions?

Senator MITCHELL. I would like to ask Mr. Davidson, if he could explain the relationship between the Federal Unemployment Tax Act and the State law in Maine and possibly in Texas. If Mrs. Anderson wants to supplement his answer, I would welcome that as well.

Mr. DAVIDSON. Yes, Senator Mitchell.

Maine is a piggyback State, and in that case when the Federal law is activated, so is the State law. And conversely so. So, if we have the Federal unemployment in effect, we have a triply whammy from the State, which is quite expensive.

Senator MITCHELL. And is the tax rate identical?

Mr. DAVIDSON. No. Well, in the State of Maine, to be specific, the base rate is 3.6 percent; so that's approximately a multiple of more than three of the Federal rate, effectively.

Senator MITCHELL. If the exemption is made permanent, there will also be a permanent exemption, then, from State law, so long as State law remains as it is?

Mr. DAVIDSON. Yes, it would—precisely.

Senator MITCHELL. Ms. Anderson.

Ms. ANDERSON. Senator Mitchell, Texas is the same as Maine, the State follows Federal. If we become exempted under Federal, we would then be exempted at the State level.

Our rates do run a little different in Texas; usually it is about a 2.7. In some areas where we have a severe economic depression, some of the rates can run a maximum of 8.44 percent at the State level, and some of the vessel owners are being assessed this. Part of that is to help rebuild an exhausted fund in the State of Texas, even though maybe we don't have claims against it, sir.

Mr. GREENBERG. Senator Mitchell.

Senator MITCHELL. Yes; go ahead.

Mr. GREENBERG. I would just add for the record that the State of Florida; where a majority of southeastern's members are from, is also a State which tracks the Federal system.

Senator MITCHELL. Ms. Sloan, you represent fishermen from all over the country, including the west coast. Is that correct?

Ms. SLOAN. Yes, sir.

Senator MITCHELL. And you have here representatives of the East, Southeast, and the Southwest, I guess. Is it fair to say that fishermen on the west coast are as concerned about the unemployment tax as are their counterparts in the rest of the country?

Ms. SLOAN. Easily, Senator Mitchell; as Senator Packwood knows, this has been a continuing problem for them as well.

Senator MITCHELL. Thank you very much.

Senator PACKWOOD. Thank you very much. We appreciate it.

Next we will move on to S. 1809, and we have a two-person panel: James Warner and Edwin Cohen.

Good morning.

Mr. COHEN. Good morning.

Senator PACKWOOD. Mr. Cohen, I know you are well familiar with our rules. I don't know if Mr. Warner is or not, but your statements will be in the record in their entirety, and if you could hold yourself to our 5-minute limits I would appreciate it very much.

Are you going to go first, Eddie, or Mr. Warner?

Mr. COHEN. I would be happy to go first, Mr. Chairman.

**STATEMENT OF EDWIN COHEN, ESQ., COVINGTON & BURLING, WASHINGTON, D.C., ON BEHALF OF THE INVESTMENT COMPANY INSTITUTE, WASHINGTON, D.C.**

Mr. COHEN. Mr. Chairman, I think we are in complete agreement on our position.

I am here on behalf of the Investment Company Institute, which is the national association for the mutual fund industry, known in the Internal Revenue Code as "regulated investment companies."

S. 1809 introduced by Senator Baucus last summer, I believe, would deal with one specific issue, and the Investment Company Institute would support that bill. But we have been working with the Treasury Department and the congressional staffs for the past year to deal not only with that one particular case but to provide a broader solution that would prevent that technical problem from arising in the future in other similar circumstances.

We have arrived at an agreement on that. It has been incorporated in the bill recently reported out by the Ways and Means Committee. And according to a press release of the Senate Finance Committee, we understand it has been adopted by the committee.

Senator PACKWOOD. I might say a proof of your effectiveness, Mr. Cohen, is the fact that the Treasury supports this. This subcommittee hears dozens and dozens, of witnesses on a variety of what are called small bills. The Treasury normally opposes all of them. In this case, they do support it. I'm sure, it is in great measure, due to your successful work.

Mr. COHEN. Well, I think that the broader solution which the institute prefers takes care of the problem dealt with in S. 1809, and therefore makes that bill unnecessary.

There is one minor sentence or two that we understood was to be added into the bill, which for some reason has not been put in the House version of the bill but we hope will be added by the staff in the Senate bill.

Senator PACKWOOD. Let me ask you this, and this is critical: If it is not in the House bill, do you know if it was added in the Senate bill?

Mr. COHEN. I have not seen the language in the Senate bill. It is a minor technical point to which I think there is no objection.

Senator PACKWOOD. All right.

[Mr. Cohen's prepared statement follows:]

STATEMENT OF
EDWIN S. COHEN
ON BEHALF OF THE
INVESTMENT COMPANY INSTITUTE
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE SENATE COMMITTEE ON FINANCE
REGARDING
S. 1809

March 16, 1984

My name is Edwin S. Cohen. I am a partner in the law firm of Covington & Burling, Washington, D.C., and I appear before the Subcommittee today on behalf of the Investment Company Institute.

The Institute is the national association of the mutual fund industry. Its membership includes more than 900 open-end investment companies (referred to generally as "mutual funds"), their investment advisers and principal underwriters. The Institute's mutual fund members have assets of more than $260 billion and have approximately 16 million shareholder accounts.

S. 1809, introduced August 4, 1983 by Senator Baucus, would, as the press release for this hearing describes it, "disregard the attribution between limited partners of stock of a publicly owned investment company for the purpose of determining whether that company is a personal holding company or a regulated investment company."

The Institute supports S. 1809 and believes that the relief it provides in that specific situation is desirable. However, the possibility of a company being disqualified as a regulated investment company because of a technical problem

stemming from the intricacies of the stock ownership rules relating to personal holding companies can arise in other situations, in some cases without the company even being aware of the existence of the problem.

Accordingly, over the past year or so the Institute has reviewed the matter with the Treasury Department and the Congressional staffs, as a result of which an alternative proposal has been developed to prevent this type of problem from arising and which will have a broader application. The broader proposal will take care not only of the specific matter dealt with in S. 1809, but also other similar technical problems that might otherwise arise in the future.

The broader provision is contained in section 810(a) of H.R. 4170 as ordered reported by the Ways and Means Committee in the House on March 5, 1984. We understand that the same proposal was approved by the Senate Finance Committee on March 8, 1984. Press Release No. 84-4 of the Finance Committee, dated March 12, 1984, states on p. 12, in item 16:

> "Under present law, a personal holding company cannot qualify as a regulated investment company (RIC). * * * *
>
> "Under the proposal, a personal holding company could qualify as a RIC * * * *"

It is our understanding that the Finance Committee intended to approve the provision contained in section 810(a) of the House bill and that this provision would take care of the specific situation covered by S. 1809, together with other

comparable cases that might also arise. The Institute prefers the broader provision contained in the House bill and already approved by the Committee on Finance.*/

Section 810 of the House bill and the action of the Senate Finance Committee on March 8, 1984, as reflected in the press release, also correct a technical problem relating to accrual by regulated investment companies of original issue discount on short-term obligations. In addition, Section 622(b) of the House bill corrects another technical problem relating to the flow-through of the character of tax-exempt interest distributed by regulated investment companies to their shareholders. The Institute also supports both of those provisions.

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*/ Section 810(a) of H.R. 4170, as ordered reported by the Ways and Means Committee, inadvertently omitted a technical provision concerning permissible distributions that the Treasury Department and the Congressional staffs had earlier agreed to in concept. The Institute's support for the House bill includes the expectation that the omitted provision will be included in the final version of the bill.

**STATEMENT OF JAMES C. WARNER, ESQ., LEE, TOOMEY & KENT, WASHINGTON, D.C., ON BEHALF OF BAILARD, BIEHL & KAISER, INC., MENLO PARK, CALIF.**

Mr. WARNER. I am here on behalf of Bailard, Biehl & Kaiser, Inc., an investment counseling firm in California, and we are in full agreement with the Investment Company Institute's position on this. If, as we understand the case to be, the Senate Finance Committee has adopted the provisions proposed by the Ways and Means Committee in section 810 of H.R. 4170, further consideration of S. 1809 would be unnecessary.

Senator PACKWOOD. Unless something goes awry, I think you can be assured of that. And all that could go awry, I think, is if we have no tax bill at all, and it looks like we are on track with a tax bill.

Mr. WARNER. Yes.

[Mr. Warner's prepared statement follows:]

STATEMENT OF JAMES C. WARNER
TO THE SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT
RE: S. 1809
MARCH 16, 1984

Mr. Chairman and Members of the Subcommittee:

My name is James C. Warner. I am a partner with the law firm of Lee, Toomey & Kent in Washington, D.C. On behalf of Bailard, Biehl & Kaiser, Inc., an employee-owned investment consulting firm, I thank you for this opportunity to comment on S. 1809. For the reasons discussed herein, Bailard, Biehl & Kaiser strongly urges your Subcommittee to adopt S. 1809, or to eliminate the requirement of section 851(a) of the Internal Revenue Code that a regulated investment company ("RIC") cannot be a personal holding company ("PHC").

To qualify as a RIC under present law, a mutual fund must meet several requirements. For example, it generally must be registered under the Investment Company Act of 1940 (I.R.C. § 851(a)(1)); it must derive at least 90 percent of its income from investments (I.R.C. § 851(b)(2)); and it must distribute at least 90 percent of its annual investment income as dividends (§ 852(a)(1)). These requirements are in keeping with the basic purpose of the RIC provisions: To permit small investors to obtain risk diversification and professional management of their investments through a regulated mutual fund but to have their investments taxed as if they were

directly owned. See H. Rep. No. 1681, 74th Cong., 1st Sess. (1935), reprinted in 1939-1 C.B (part 2) 642, 644 (letter from President Roosevelt to Congress); H. Rep. No. 2020, 86th Cong., 2d Sess. 3-4 (1960).

The requirement of section 851(a) that a RIC must not be a PHC, however, has caused a technical problem. The original purpose of the PHC prohibition was to limit the flow-through treatment provided by the RIC provisions to widely-held mutual funds. (Since the PHC income test is automatically met by most mutual funds, the effect of the PHC prohibition is to deny RIC status to mutual funds that are so closely held that they meet the PHC stock ownership test.) Later, however, attribution among partners was added to the PHC stock ownership rules for reasons that had nothing to do with RICs. Under section 544(a)(2), a partner is deemed to constructively own any stock owned by other members of the same partnership, thereby literally covering both active and limited partners. This creats a technical trap, as illustrated by Rev. Rul. 82-107, 1982-1 C.B. 103. In that ruling, section 544(a)(2) prevented a regulated mutual fund from qualifying as a RIC because some of the shareholders in the fund had passive limited partnership investments in common. Indeed, if any number of persons owning 51 percent of a mutual fund's stock have limited partnership interests of any size in any of five totally unrelated limited partnerships, the PHC

constructive ownership rules of present law will prevent the mutual fund from qualifying as a RIC. Countless other fortuitous combinations will produce the same results. This clearly is unintended because the shareholders of a regulated mutual fund usually do not even know each other.

As indicated by the Treasury Department letter which is attached to this Statement as Exhibit A, the Treasury Department has recognized this technical problem, and it supports S. 1809 as corrective legislation. S. 1809 would prevent a regulated mutual fund with at least 100 unrelated shareholders from losing its flow-through tax treatment under the RIC provisions merely because some of the shareholders have passive limited partnership investments in common.

Indeed, it would be desirable to eliminate the PHC prohibition entirely, as the House Ways and Means Committee has proposed in section 810 of H.R. 4170. This is because the original function of the PHC prohibition--to limit flow-through tax treatment of investment income to widely-held mutual funds--has been largely eroded. Since S corporations need not be widely held to benefit from flow-through treatment of their investment income, there appears to be no reason why a closely-held RIC should be treated differently. The Treasury Department has recognized this fact in its support of section 810 of H.R. 4170. H.R. 4170 would terminate the PHC prohibition and instead tax a RIC which is a PHC on

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its undistributed income at the highest corporate tax rate. According to the Senate Finance Committee Statement on Actions Taken During Recent Markup on Deficit Reduction Package released March 12, 1984, the Committee has tentatively agreed that "a personal holding company could qualify as a RIC". Bailard, Biehl & Kaiser understands that in doing so the Committee intended to adopt the provisions of section 810 of H.R. 4170. If the Senate Finance Committee adopts the provisions of section 810 of H.R. 4170, further consideration of S. 1809 would be unnecessary.

Mr. COHEN. Senator, may I mention one other point that is in the bill as it was on the House side, and according to the press release it is also in this bill?

In 1982, the committee adopted an amendment, a technical amendment, that we thought was necessary with respect to tax-exempt interest that flows through investment companies of mutual funds. Again, that was worked out with the Treasury Department.

In the same year in another bill, we had the right to issue tax-exempt interest for 2 years.

The provisions of the two bills both modified section 103. As they passed the Congress and were adopted they were adopted in the right order, but when they were signed by the President they were signed in the inverse order, leaving some possible question as to whether the Indian tribe bill had repealed the one just enacted 1 week earlier. That is clarified in this bill, to make sure that the laws will be construed in the order in which the two bills passed the House.

I have seen an announcement of a bill introduced to make the right of the Indian tribes to issue tax-exempt bonds permanent. I would just hope that if that is also contained in this bill, that we don't repeat the problem that we had 2 years ago and need still another technical correction.

Senator PACKWOOD. Again I will say, Eddie, you are probably the only person in Washington who would have caught that. I didn't know that was a problem. I didn't know we had done that.

Mr. COHEN. Well, I think it is just a matter of being sure that if both provisions are in the same bill, or if they are enacted in separate bills, that we don't have the same problem recur in 1984.

Thanks, Senator.

Senator PACKWOOD. Thank you very much.

Gentlemen, I appreciate it.

Without objection I will put a statement of Senator Baucus in the record just prior to the statement of the two witnesses.

Mr. COHEN. Thank you.

Senator PACKWOOD. Now we will conclude with S. 2080, and we will start with a panel of Patrick Keating; Steve Koplan, accompanied by Alan Reuther and Jack Curran; and Joe Ruth accompanied by William Bolger.

Mr. KOPLAN. Mr. Curran is coming along.

Senator PACKWOOD. Why don't we go ahead and start.

I wonder, Steve, if you, Mr. Reuther and Jack would be able to stay through the last panel? I would like to talk with you and a couple of people on that panel when we are done with the hearing, just very briefly.

Mr. KOPLAN. Certainly, Senator.

Senator PACKWOOD. Thank you.

Why don't we just start with Mr. Keating.

## STATEMENT OF PATRICK J. KEATING, ESQ., AMERICAN BAR ASSOCIATION, WASHINGTON, D.C.

Mr. KEATING. Mr. Chairman, my name is Patrick Keating. I am chairman of the Special Committee on Prepaid Legal Services of the American Bar Association, and I have been in private practice of law for 30 years in Detroit, Mich.

I am appearing here today at the request of Wally Riley, the president of the American Bar Association, who couldn't be with us. He asked me to point out that the board of governors of the American Bar has selected passage of this S. 2080 as one of a small group of top legislative priorities for 1984, and he wanted me to point out that the ABA strongly believes that making permanent section 120 of the Internal Revenue Code provided in this bill addresses a matter of critical importance to millions of people throughout the country.

We filed a statement in the matter, and I would like to take just a minute or two to point out some points of interest that we have already covered.

One of those is that, first of all, we have found that this provision of section 120 provides employees with a way to handle their personal problems that would not otherwise be available and which could interfere with their work at home and on the job. I think any lawyer can tell you of instance after instance after instance that has come into his office where people have delayed confronting the personal problems that they have run into in a legal way, simply because they don't know what to do.

The common remark of a lawyer of, "If only the client had seen me on time, the trouble could have been avoided," is certainly true, but also a lot of times it echoes in an empty cavern for two reasons: First of all, the client doesn't know when the earlier time is; and second, there is the matter of cost. As far as the matter of the early time, if it is provided that he has access to a lawyer by telephone, he does know when that time is, because whenever he is confronted with any kind of a legal problem all he has to do is pick up the phone and call the lawyer.

After much experimentation, plans have been devised which promote the use of lawyers' services on a preventive basis, and that is one of the biggest developments and one of the real surprises of these prepaid legal programs; it is that over 80 percent of the prob-

lems of the average citizen can be handled in telephone conferences with lawyers.

The second matter of cost is also a matter of very serious concern to the client, and our experience has shown that the cost of legal services is perceived by the average citizen as an impossible burden. Even when they desperately need a lawyer, they view it as an avoidable discretionary expense.

We have learned that when the cost of these services is borne by the fund, that the cost is minimal, and that the costs are modest, and the projected tax revenue loss is minimal. The cost to the employer of providing this benefit has increased only marginally and certainly at a rate less than that of inflation. Since 1976, the number of people covered under these plans has grown from less than 100,000 to an estimated 4 million to 5 million today. We have insurance companies involved, and as you will hear today, there are unions. The unions are here with us, advocating the making permanent of this Section 120.

Thank you.

[Mr. Keating's prepared statement follows:]

STATEMENT

of

PATRICK J. KEATING

on behalf of the

AMERICAN BAR ASSOCIATION

before the

COMMITTEE ON FINANCE
UNITED STATES SENATE

on the subject of

S.2080, GROUP LEGAL SERVICES TAX PROVISION

March 16, 1984

Mr. Chairman and Members of the Subcommittee:

My name is Patrick J. Keating. I am the Chairman of the Special Committee on Prepaid Legal Services of the American Bar Association and I am in the private practice of law in Detroit, Michigan.

I am appearing here today at the request of Wallace D. Riley, President of the American Bar Association, who regrets that he is not able to appear personally because of an important prior commitment.

The ABA strongly believes that the making permanent of Section 120 of the Internal Revenue Code as provided in this bill addresses is of critical importance to millions of people throughout the country. Indeed only last month our Board of Governors selected passage of S. 2080 as one of a small group of top legislative priorities for 1984.

As the Committee knows, Section 120 determines the tax treatment of qualified group legal services plans. It provides that employees may exclude from their taxable income contributions made by an employer to such a plan and the value of any legal services received by the employee under the plan. I would like to state briefly why the American Bar Association has supported this tax treatment of employer paid legal plans and why we feel that the permanence of Section 120 is critical at this juncture.

Recognizing the need to develop mechanisms to help middle-income Americans gain access to personal legal services, the American Bar Association has worked for over ten years to develop and perfect the concept of prepaid legal services. In 1974, we joined with a

coalition of labor, insurance, consumer and other groups to create an incentive for employers to provide legal services as a benefit for employees for much the same reason as they provide medical and other insurance benefits: to assure the personal well-being of employees and their families so that they can continue to be permanent and productive members of the workforce. If an employee is sick, he or she cannot work. Being ill in the workplace can greatly reduce productivity. By establishing tax incentives for employers to provide or pay for medical care, the Congress has recognized the economic benefits inherent in protecting an employee's physical health.

Legal problems can affect the emotional and financial health of employees. Financial problems often have legal implications. Falling behind in mortgage or loan payments can lead to wage garnishment and the possibility of eventual bankruptcy, both of which may involve not only the employee but the employer and the economy as well.

The incidence of these problems can have a significant effect on an employee's work productivity and often lead to to absences from work to go to court or otherwise deal with a problem personally. The following case study was compiled from actual cases where what initially was a minor personal problem led to serious personal and legal trouble:

Robert Simpson (fictitious name) worked as a quality control inspector at an electronics plant for six years. During that period, his performance evaluations were excellent and his

attendance record perfect. Mr. Simpson was well-liked by his fellow employees and was credited with making a number of suggestions which markedly improved quality control procedures. He was active in his local union and was being considered by management for promotion to supervisor of his section.

In the seventh year of his employment, the quality of components coming off the assembly line where Mr. Simpson was stationed dropped off sharply. In addition, his attendance record began to deteriorate and he was absent from a number of important union meetings. Supervisors and co-workers tried unsuccessfully to ascertain the reason for this change in Mr. Simpson's behavior. He became short-tempered, explaining that he had a few minor personal problems he would take care of shortly. At one point, Mr. Simpson's job performance declined so much that both his co-workers and management feared that he might not only lose the chance for promotion but also his job as well.

Mr. Simpson's job performance suffered because he was distracted by serious legal difficulties. At the conclusion of his sixth year of employment, he moved his family to an older apartment building in a northwest suburb of the city. Simpson entered into a two-year lease, but did not consult an attorney as to the terms of the lease agreement. A month after the Simpson family moved in, a small fire broke out on the first floor of the building, and Mr. Simpson, who lived on the third floor, became concerned over the need for fire protection. The landlord refused to provide alarms and extinguishers, and Mr. Simpson, not the smartest of businessmen,

decided to purchase $2,400 worth of fire protection equipment on an installment note.

Had Mr. Simpson talked to a lawyer before purchasing the equipment, he would have discovered that the landlord was obligated by both state law and municipal ordinance to provide fire protection equipment. He would also have been shown where the lease agreement he entered into specifically stated that the landlord would provide such equipment on request and that rent could be withheld if such a request was not honored.

Three months after the purchase of the equipment, Mr. Simpson discovered that he could not meet the installment payments. The finance company refused to listen to any excuses and promptly sued Mr. Simpson for $2,400 in municipal court. Mr. Simpson, unaware of the ramifications of the suit and without funds to retain a lawyer, failed to answer the complaint and a default judgment was entered against him. The fire equipment was repossessed and sold at a sheriff's sale for $400, with a deficiency balance of $2,000 showing as an unsatisfied judgment on the record of the court. Mr. Simpson was then summoned to court on a judgment-debtor hearing and his wages were immediately garnisheed.

Over the next six months, as Mr. Simpson attempted to pay off the judgment against him, his other monthly obligations fell into arrears. He lost his gasoline credit card, the rent was always late and his other creditors began harassing him for payment of his obligations. Several law suits were filed, all resulting in default

judgments. Mr. Simpson attempted to secure a loan to relieve his financial burden, but loan companies refused to consider his application because of the court judgments.

Mr. Simpson became short tempered and abusive with his wife and children -- a changed man with his family. Because of the change in him and the pressure of continual harassment by creditors, Mrs. Simpson informed her husband that she had had enough and filed for divorce. Simpson was served with the complaint at work, much to his embarrassment, along with motions for expense money, temporary alimony and support and custody of the children. Ironically, since the rent was once again late, the landlord filed for eviction. During the next six months, numerous hearings on the pending divorce were held and Mr. Simpson had little time for anything but the legal battles that surrounded him.

Could an attorney have prevented many of Mr. Simpson's problems? Probably. Certainly, an attorney's review of the original lease agreement might have prevented the credit purchase of the fire prevention equipment in the first place which seems to have led to many of his other difficulties. Even assuming that the purchase had been made anyway, many of the judgment-debtor problems could have been immediately relieved through the attorney's active participation with creditors. The divorce might well have been avoided if the credit problems had been alleviated initially. Even if the divorce was unavoidable, the availability of an attorney prior to the initiation of the suit by Mrs. Simpson could have prevented a lengthy contested proceeding.

Is this case atypical? We don't think so, though certainly many situations can turn out to be less disastrous. Let's take a "minor" matter which actually occurred in a midwest office.

An employee was billed by a hospital for approximately $130 which he thought he didn't owe and which he had no money to pay in any event. Repeated requests for payment were ignored until the employee received a summons from county court located 35 miles away from the office. The employee mentioned the need to take time out from work to go to court to his supervisor, who advised that the employee talk to a lawyer first. A lawyer was consulted and eventually accompanied the employee to court twice, requiring the employee to be absent from work for one-half day each time, and a settlement with payment arrangements was worked out with the lawyer for the hospital.

The cost to the employee associated with this problem was calculated at $358.84, including $225 in attorney fees, $59.84 in lost wages, $28 in transportation to court and $46 in court fees. In addition, the employer lost the services of the employee for two mornings, the federal government lost approximately $11.80 in tax revenue on the employee's lost earnings and the hospital had to pay its attorney to handle the case in court.

The point of this story is that the attorney indicated afterward that had she been called as soon as the employee started receiving past-due notices from the hospital, she could have negotiated a payment schedule with the hospital by phone, avoiding the law suit,

court appearances, costs, time off from work and the worry which had plagued the employee during the three months while this situation was developing.

How could an employer-paid legal benefit plan have helped in this second, more typical case? First, the employee, realizing that arrangements for consulting and paying for a lawyer were part of his compensation, the question of whether the employee had the funds to hire an attorney would not come up. Secondly, by having this barrier removed, the employee would have had the incentive to consult a lawyer early as soon as the problem presented itself, rather than waiting until the last minute and having a law suit filed against him. Third, the employer would not have lost the services of the employee both for the time taken to go to court and in the preceding months during which the employee's attention was distracted from his work because of worry and phone calls to and from the hospital.

Will employees actually take advantage of a legal services benefit to their own and the employer's advantage? The statistics we have gathered since Section 120 was enacted in 1976 indicates that they will. A comprehensive survey of the legal needs of the public published in 1977 by the American Bar foundation and carried out by the National Opinion Research Center indicated that more than 35% of the population encounter problems each year that could be resolved by a lawyer, yet only 10% actually seek legal assistance. In contrast, our information indicates that an average of 20% of the employees covered by a group legal plan consult a lawyer at least once annually.

These employee-users are in a majority of cases receiving preventive legal assistance that often make it possible to avoid litigation or serious, protracted remedial services. Some of the newest prepaid legal plans feature legal advice and consultation by phone as a benefit. The adminis'rators of these plan have told us that between 60% and 80% of the problems presented by plan members can be resolved over the phone in one or two calls or with telephone negotiation with adverse parties.

It is clear to us that after 10 years of experimentation with prepaid legal service plans, the promise that they hold for establishing a private-sector mechanism for delivering needed personal legal services to employees has been fulfilled. Direct tax revenue loss is considered minimal, as indicated in the March, 1983 estimates prepared by the staff of the Joint Committee on Taxation. Further, we suggest that tax dollars can even be saved by reductions in the use of our courts to resolve minor disputes as a result of preventive legal services being made available to employees through qualified group legal service plans. And the benefit to our economy of minimizing the impact of employee personal and legal problems on productivity in the workplace should not be taken lightly.

In 1976, Congress acted wisely in incorporating a termination provision in Section 120 which would force us to evaluate the efficacy of this tax policy in stimulating the development of plans which provide access to needed personal legal services. Further, controls built into Subsection (c)(1) of Section 120 assure that qualified group legal service plan will not discriminate in favor of

highly-paid employees and wealthy owners of businesses, thereby insuring that middle-income Americans are the major beneficiaries of these plans. We are convinced that the plans have proved themselves, and we know that employers throughout the country are planning to incorporate legal service benefits into their compensation programs as soon as the taxation questions raised by the pending expiration of Section 120 have been resolved.

We urge that S.2080 be passed into law at the earliest date possible so that the millions employees who now take advantage of employer-furnished legal services can continue to do so and so that employers who have recognized the value of this benefit in maintaining good employee relations and productivity can move forward to implement a qualified group legal service plan.

Senator PACKWOOD. I might say Jack Curran is well familiar with this issue. He brought the question to me in 1975 or 1976, when the IRS was trying to enforce tax payments on the Laborers' Union. The union had operated a plan for 2 or 3 years.

I recall the total cost was something like $50 or $60 a year, and the tax would have been—I will take a guess—$5 or $10. I thought to myself: The IRS must have something better to do than go after the members of the Laborers Union for this miniscule amount of taxes. That was the birth of the prepaid legal law. We have to fight it every time we need to extend it. One day I hope we make it permanent so we don't have to go through this fight.

Gentlemen, go ahead.

## STATEMENT OF STEVE KOPLAN, LEGISLATIVE REPRESENTATIVE, AFL-CIO, WASHINGTON, D.C.

Mr. KOPLAN. Thank you, Mr. Chairman I might say, if it doesn't happen it certainly won't be for your lack of effort in trying.

Mr. Chairman, I am accompanied this morning by Jack Curran, legislative director of the Laborers International Union, and Alan Reuther, assistant general counsel of the United Auto Workers. Both of these gentlemen have individual statements of their own that will be submitted for the record but are here to answer any questions you might have at the conclusion of my testimony.

I will summarize my statement.

Mr. Chairman, the AFL-CIO appreciates this opportunity to present its views in support of S. 2080, a bill which you introduced last fall, to make permanent section 120 of the Internal Revenue Code and thus continue to encourage qualified group legal service plans.

We believe that current tax treatment of qualified group legal service plans has helped in encouraging the use and protections of

such plans at minimal cost. There is no evidence that such plans have been abused, exploited as tax shelters, or led to inequities or discriminatory practices.

Congress has acted three times in the past in support of group legal services plans, as you well know. We urge that the committee act favorably upon S. 2080 and thus make the current tax treatment of qualified group legal service plans a permanent part of the tax law.

We believe this section should become permanent and the uncertainty about their status ended. An average of 20 percent of covered employees in a group plan obtain legal assistance, and for the most part they are receiving preventive legal services that often make it possible to avoid litigation or serious or protracted remedial services. This of course helps employees and assists in unblocking our overburdened judicial system.

By making advance arrangements on a group basis, the time costs and uncertainty involved in selecting and consulting a lawyer when a legal question arises is dramatically reduced. Thus, though these people covered by a plan tend to contact a lawyer more often, they do so at an earlier point in the course of a problem. As a result, more people receive legal advice, matters are handled at lower cost, and in a way that minimizes disputed litigation.

The legal services provided by plans are those most often needed by average citizens, starting with initial legal consultations, advice and routine follow-up, and continuing through routine matters such as wills, divorces, real estate transactions, consumer matters, and so on, depending on the level of plan funding.

Plans generally tend not to cover matters subject to contingency arrangements such as personal injury and probate cases. Almost all plans cover the employee and his family. Coverage for retirees is also frequently provided. Although legal services plans fill a real and important need, their cost is modest. It is unlikely that the cost of legal services plans will rise appreciably.

The average person does have real needs for legal services that now generally go unmet, but those needs can be satisfied inexpensively through group legal services plans. Such plans also help keep legal fees reasonable through the bargaining power of group plans.

The average revenue loss associated with group legal services plans is $25 million, according to the Joint Committee on Taxation, and using the National Resource Center's average employer-paid plan cost of $87 per year and a 20-percent marginal rate of taxation, that amounts to $17.40 per covered family per year.

Few sections of the Tax Code have so clearly achieved their objectives at such a low cost and with so little abuse. We believe that workers should not have to pay taxes on employers' contributions to qualified legal services plans.

I should like to close by noting that the AFL–CIO convention has specifically endorsed this particular provision of the code to be continued.

Mr. Chairman, we believe S. 2080 is consistent with the principles enunciated at the convention, and we therefore support its enactment and sincerely appreciate your efforts in this regard.

Senator PACKWOOD. I know you have been covering the VEBA debate we have had in the last several days. We need to get all plans to have the coverage and the protection that collective bargaining plans have and eliminate the abuses that come from plans that are not bargained. All of the abuses that are cited, not one comes from a collectively bargained plan. And yet, those who don't like untaxed fringe benefits are going to try to use those specific examples in small private corporations, for the benefit of a few partners or shareholders, to drive a wedge into the heart of this whole concept. That is partly why I want to meet with you afterward, and talk just a moment about some strategy that we need to work out to make sure we don't trod down that road.

Mr. KOPLAN. Well, let me say that I happen to have been present in the room when you eloquently debated that issue on VEBA's. Again, we appreciate your efforts in that regard as well. And we will be happy to meet with you at the close of this hearing on that.

Senator PACKWOOD. Thank you.

Mr. Reuther? Mr. Curran?

[Mr. Koplan's prepared statement follows:]

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**STATEMENT OF STEPHEN KOPLAN,
LEGISLATIVE REPRESENTATIVE, DEPARTMENT OF LEGISLATION,
AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS
ON S. 2080, TO MAKE PERMANENT A TAX PROVISION TO ENCOURAGE EMPLOYERS
TO PROVIDE LEGAL SERVICES FOR THEIR EMPLOYEES,
BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
U.S. SENATE FINANCE COMMITTEE**

**March 16, 1984**

Mr. Chairman, the AFL-CIO appreciates this opportunity to present its views in support of S. 2080, a bill to make permanent Section 120 of the Internal Revenue Code and thus continue to encourage qualified group legal service plans. We believe that current tax treatment of qualified group legal service plans has helped in encouraging the use and protections of such plans at minimal cost. There is no evidence that such plans have been abused, exploited as tax shelters, or led to inequities or discriminatory practices.

Congress has acted three times in the past in support of group legal service plans. We urge that the Committee act favorably upon S. 2080 and thus make the current tax treatment of qualified group legal service plans (Code Section 120) a permanent part of the tax law. In 1973 Congress amended the Taft-Hartley Act to permit the use of employee benefit trusts to provide legal services. In 1976 Congress enacted section 120 for five years. In 1981 it was extended for three more years. We believe the section should become permanent and the uncertainty about their status ended.

Legal service plans exhibit considerable diversity in structure, cost and benefits, depending on the group of people covered -- their number, geographic distribution, family situation, etc. -- and the funding available.

All plans help remedy the unmet legal service needs. Studies show that some 35 percent of the population each year encounter problems that could be solved by a lawyer but only 10 percent actually seek legal assistance. By contrast, an average of 20 percent of covered employees in a group plan obtain legal assistance and for the most part they

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are receiving preventive legal services that often make it possible to avoid litigation or serious or protracted remedial services. This of course helps employees and assists in unblocking our overburdened judicial system.

By making advance arrangements on a group basis, the time, cost and uncertainty involved in selecting and consulting a lawyer when a legal question arises is dramatically reduced. Thus, though these people covered by a plan tend to contact a lawyer more often, they do so at an earlier point in the course of a problem. As a result more people receive legal advice, matters are handled at lower cost and in a way that minimizes disputed litigation.

The legal services provided by plans are those most often needed by average citizens, starting with initial legal consultations, advice and routine follow-up, and continuing through routine matters such as wills, divorces, real estate transactions, consumer matters and so on, depending on the level of plan funding. Most plans attempt to provide reasonably generous benefits in case the individual is sued in civil court. Some plans provide some coverage in criminal cases. Traffic and misdemeanor matters are more often covered than felonies. Sometimes only the emergency stages (arraignment and bail) of criminal matters are covered. Plans generally tend not to cover matters subject to contingency arrangements, such as personal injury and probate cases. Some plans cover court costs and other litigation expenses. Almost all plans cover both the employee and his family. Coverage for retirees is also frequently provided. Although legal service plans fill a real and important need, their cost is modest.

A plan that provides unlimited telephone advice and consultation with an attorney, some limited follow-up and reduced fees for additional services costs between $15 and $60 per family per year. More comprehensive legal service plans cost between $70 and $250 per family per year and a 1979 study by the National Resource Center for Consumers of

Legal Services found the average cost of an employer paid plan to be $87 per family per year. It is also unlikely that the cost of legal service plans will rise appreciably. The average person does have real needs for legal services that now generally go unmet -- but those needs can be satisfied inexpensively through group legal service plans. Such plans also help keep legal fees reasonable through the bargaining power of group plans.

Health plans have only recently, through Preferred Providers Organizations (PPO's) and Health Maintenance Organizations (HMO's), begun to use their bargaining leverage with doctors and hospitals the way legal service plans have been bargaining with lawyers for over a decade.

The annual revenue loss associated with qualified group legal service plans is $25 million, according to the Joint Committee on Taxation and using the National Resource Center's average employer-paid plan cost of $87 per year and a 20 percent marginal rate of taxation, that amounts to $17.40 per covered family per year. In 1981 the UAW-Chrysler plan, then the second largest plan and the only truly nationwide prepaid plan, cost just under $30 per year. The cost to the Treasury was about $6 per family. Similarly, the huge new UAW-General Motors plan covering 1.4 million people is funded at just 3¢ per hour. That contribution of about $40 per employee per year covers families, retirees and their families, and recently laid off workers as well.

If section 120 is made permanent it is likely that the $25 million figure will grow as more people become covered. Nevertheless few sections of the tax code have so clearly achieved their objectives at such a low cost and with so little abuse. We believe that workers should not have to pay taxes on employers contributions to qualified legal service plans.

I should like to close by noting that in 1979 the AFL-CIO Convention set forth general standards with respect to the taxation of fringe benefits. The Convention urged

principles as:

1. Sensible "de minimis" rules so that employers and employees need not take into account small benefit values which would cause unreasonable record keeping and administrative burdens.

2. Benefits that faciliate the employee's work performance, are provided for the convenience of the employer, or other support services, such as the furnishing of uniforms should not be taxed.

3. Limited benefits historically and broadly available such as discounts for employees of retail stores should be exempt from taxation.

4. Provisions of present law which under specified conditions expressly grant tax exemptions for fringe benefits including, among others, qualified pension plans, group life insurance, health benefits, and group legal services should be continued.

We believe S. 2080 is consistent with those principles and we, therefore, support its enactment.

## STATEMENT OF ALAN REUTHER, ASSISTANT GENERAL COUNSEL, INTERNATIONAL UNION, UNITED AUTO WORKERS, WASHINGTON, D.C.

Mr. REUTHER. Let me just say, on behalf of the UAW, we appreciate the opportunity to present our views on S. 2080 here today.

We now have approximately 629,000 members and their families covered under negotiated group legal services plans. Our experience has been that these plans are very effective in providing low-cost quality legal services to our members. We believe that the continuation of section 120 is crucial to the continued growth and development of these plans, and we appreciate very much your efforts in sponsoring S. 2080. The UAW fully supports this legislation.

Senator PACKWOOD. Let me ask a quick question: In terms of the use of lawyers under the UAW's plan, do you have house lawyers that you use, or do you refer people out to a selected list? Or do the people just call up who they want, and they get paid a certain amount of their legal fee regardless of who they call?

Mr. REUTHER. Generally, we try to establish a delivery mechanism that is similar to the HMO model.

Senator PACKWOOD. Good.

Mr. REUTHER. Where the concentration of employees and retirees is high enough, we usually follow a staff approach. There are attorneys who are paid on a regular salary basis who provide the services. Where the concentration is lower, we usually follow a closed-panel approach, where the member is able to go to any one of a number of attorneys who have agreed to perform the services for predetermined rates.

Senator PACKWOOD. Jack, any comments?

Mr. CURRAN. Yes, sir.

[Mr. Reuther's prepared statement follows:]

March 16, 1984

Statement on

S. 2080

Alan Reuther, Assistant General Counsel, UAW

before the

Subcommittee on Taxation and Debt Management

of the

Committee on Finance
United States Senate

In behalf of:

International Union, United Automobile,
Aerospace & Agricultural Implement
Workers of America (UAW)

Mr. Chairman, my name is Alan Reuther. I am an Assistant General Counsel for the International Union, United Automobile, Aerospace & Agricultural Implement Workers of America (UAW). I speak on behalf of the more than one and one-half million active and retired members of the UAW and their families.

The UAW would like to thank the Committee for the opportunity to testify concerning S. 2080. We commend the Chairman for introducing this legislation, which would help to assure the continued growth and development of group legal service plans by making Section 120 of the Internal Revenue Service Code permanent. The UAW strongly supports this legislation, and urges the Members of this Committee and the entire Senate to give it prompt, favorable consideration.

The UAW has long been a supporter of group legal service plans. In our view, they represent the best means of making quality, low cost legal services available to average working men and women. Traditionally, legal services have been available in this country only to the top and bottom segments of society. The wealthy and powerful can afford to hire the best law firms. And the very poor are provided free representation through legal aid offices. Average middle class Americans have been left out in the cold. Too well off to qualify for legal aid programs, but with too little resources to be able to afford representation on their own, the average worker has simply gone without legal services.

This situation began to change because of a number of developments in the late 1960s and 1970s. The Supreme Court struck down various restrictions on group legal practice. And the Taft-Hartley Act was amended to permit group legal service plans to be collectively bargained. Most importantly, Section 120 was added to the Internal Revenue Code in 1976, making it clear that employer contributions to and services provided under qualified group legal service plans do not constitute taxable income to employees.

As a result of these developments, labor unions increasingly began to take an interest in negotiating group legal service plans as a means of assuring that their members have access to quality, low cost legal representation. I am proud to say that the UAW has been in the forefront of this effort.

In 1977, the Chrysler employees, acting on the recommendation of the International Union, voted to use monies which had accumulated in a special collectively-bargained Supplemental Unemployment Benefit reserve fund to establish and finance a group legal service program. This program, known as the UAW Legal Services Plan, began operation in 1978, and has continued to provide legal services to Chrysler employees, retirees and their families since that time. The plan currently covers approximately 45,000 hourly employees, 50,000 retirees, and their families. The plan provides full legal services, including representation in litigation, for consumer and debtor matters and real estate closings. Office work services, such as consultation, drafting, research, etc. are also provided for most other matters. Finally, with respect to non-covered matters, members can obtain referrals to private attorneys who have agreed to perform the services for reduced fees. Since 1978, the Chrysler hourly program has handled about 90,000 cases. Approximately 25% of the workers have a case opened in any given year.

In the last set of negotiations with General Motors in 1982, the UAW was also successful in negotiating a group legal service plan covering GM employees, retirees and their families. Known as the UAW-GM Legal Services Plan, this program currently provides legal services to approximately 325,000 active employees, 180,000 retirees, and their families. The plan provides benefits similar to those provided under the Chrysler program. Unlike the Chrysler program, however, the GM plan is financed by current employer contributions amounting to 3¢ per straight time hour worked (or about $48 per employee per year). The GM program opened its doors in April 1983; we

estimate that it will handle approximately 100,000 individual cases in the first year of its operations.

The UAW has also negotiated group legal service plans for the Chrysler salaried and AMC employees, retirees and their families. These plans cover another 12,000 active employees and 10,000 retirees. They provide the same general package of benefits, and are financed by current employer contributions of 3¢ per straight time hour worked and 2¢ per compensated hour respectively (about $50 and $36 per employee per year).

In all, the UAW now has approximately 629,000 active employees and retirees, along with their families, covered under negotiated group legal service plans. We are pleased to report that the response of our membership to these programs has been enthusiastic. Utilization of the services provided by the plans has been high. Furthermore, our members have expressed satisfaction with the quality of the legal services provided by the programs. Most importantly, our members have indicated that they consider group legal services to be an important and valuable fringe benefit which they are interested in preserving and expanding.

The types of legal problems handled by our group legal service plans break down as follows:

| | |
|---|---|
| 20% | consumer, debtor matters |
| 25% | family law matters |
| 20% | real estate, housing matters |
| 20% | wills, trusts, probate matters |
| 15% | all other matters (traffic, torts, criminal, administrative) |

The consumer-debtor services have proven to be especially important for our membership, which has faced financial pressures as a result of lay-offs and the recession. The real estate and probate services have also proven to be valuable. By making these legal services readily accessible to our members, they have often been able to obtain legal advice before serious problems have arisen.

In order to keep the quality of legal services high while keeping costs low, the UAW has placed emphasis on the delivery of services through HMO type mechanisms. Where the concentration of employees is large enough in an area (usually about 2000 employees), offices have been established with salaried staff attorneys providing the legal services. In other areas where the concentration of employees is lower, we have contracted with private attorneys to provide the services under predetermined fee schedules for each benefit. Our experience with these delivery mechanisms, to date, has been extremely favorable, both in terms of keeping costs low, and in terms of the satisfaction of our members with the quality of the legal services.

The UAW remains committed to the growth and development of group legal service plans which can provide quality, low cost legal services to our members. In our view, the key to the continued growth and viability of group legal service plans is Section 120 of the Internal Revenue Code. Under that provision, group legal services are treated just like other major fringe benefits, such as employer provided health insurance. That is, employer contributions to pay for the cost of the fringe benefit, and the services or benefits provided under the program, are not considered to be taxable income to employees.

Section 120 is currently scheduled to expire on December 31, 1984. If it is not extended, the incentive for employers and unions to negotiate new group legal service plans will be seriously undermined. Worse, the continued operation of existing plans

-- including those now serving over 629,000 UAW members and their families -- will be jeopardized.

Congress previously acted in 1981 to extend the favorable tax treatment conferred by Section 120 on group legal service plans for 3 years. In order to encourage the continued development and growth of such plans, Congress should now act to make Section 120 permanent. This will give employers and labor unions the assurance they need in the long term viability of group legal service plans in order to make a major commitment to such programs in collective bargaining.

Making Section 120 permanent will not cause any serious revenue loss for the federal government. The Joint Committee on Taxation has estimated that the tax expenditure associated with Section 120 amounted to only $20 million in 1982. Even assuming that the number and size of group legal service plans were to grow considerably in the future, because such plans are relatively inexpensive, the tax expenditure still would not be of sufficient magnitude to warrant concern.

In conclusion, the UAW would again like to commend you, Mr. Chairman, for your leadership in the promotion of group legal services. We wholeheartedly support the bill (S. 2080) to make Section 120 permanent. We believe passage of this important legislation will help to firmly establish group legal services as a major fringe benefit, and to thereby make legal services available to millions of middle class Americans.

## STATEMENT OF JACK CURRAN, LEGISLATIVE DIRECTOR, LABORERS UNION, WASHINGTON, D.C.

Mr. CURRAN. I want to take this opportunity to express my personal appreciation and also appreciation on behalf of the Building Trades and the Laborers International Union for the prominent part that you play in this legislation originally, and now in trying to get a permanent extender for us. Without your efforts, we wouldn't be sitting here this morning talking about an extension.

I recall very vividly the part that you played not only in the Senate Finance Committee but on the floor of the Senate and then in conference to get this legislation enacted. It has been a pleasure working with you over the years.

I think that in the final analysis, now that the plan has been in working order with many unions, the benefits that have been derived by the participants far exceed what we had originally thought of, and it is moving along, gratefully, and it should be allowed to continue. The way can continue is if we do get this permanent exemption.

Again, Mr. Chairman, we will continue to work with you, and we depend upon you to lead the charge, again, on this important piece of legislation.

I want to take this opportunity, too, to thank you for the fight that you are waging for us, the collectively bargained plans, as it pertains to the exemption for the collectively-bargained VEBA plans. We will continue to work with you in that area.

Senator PACKWOOD. I am happy to do it. It is a fight I will continue.

Mr. CURRAN. I do have a statement, Mr. Chairman, on behalf of Bob Georgine of the Building Trades and one on behalf of the Laborers International Union, which we will submit for the record.

Senator PACKWOOD. Thank you.

[Mr. Georgine's and Mr. Curran's statements follow:]

Statement on Behalf of the

Building and Construction Trades Department

of the AFL-CIO

by

Robert A. Georgine, President

before the
Subcommittee on Taxation and Debt Management
Senate Finance Committee

March 16, 1984

SUMMARY OF TESTIMONY

1. The Building and Construction Trades Department of the AFL-CIO wholeheartedly supports S.2080 and group legal service plans.

2. Our member unions have been leaders in developing plans to meet their members' needs.

3. Legal service plans provide equal access to the legal system for working Americans.

4. Plans emphasize preventive law.

5. Congress so far has an unbroken record in support of legal service plans. The evidence clearly justifies that support.

6. To reverse the judgments of the past eleven years would amount to saying either (a) that access to the legal system is unimportant for working Americans, or (b) that such access is so important that we can't let it continue. Either conclusion would be almost unimaginable.

7. Section 120 should be made permanent.

Mr. Chairman, my name is Robert A. Georgine. I am president of the Building and Construction Trades Department of the AFL-CIO, which has 15 affiliated member unions representing over 4 million American workers.

The Building and Construction Trades Department wholeheartedly supports S.2080, the bill introduced by Senator Packwood to make permanent section 120 of the Internal Revenue Code, which excludes from the gross income of employees the value of employer contributions to or services provided by a qualified group legal services plan. The Building Trades believe that Senator Packwood's bill, which already has as co-sponsors Senators Dixon, Moynihan and Stevens, is essential to insuring the availability of legal services to the American worker. We join the AFL-CIO in its testimony supporting S.2080. The labor movement joined consumers, the organized bar and the insurance industry in enthusiastically supporting section 120 in 1976, in 1981, and we do so again. But let's make it permanent this time!

The enactment of section 120 in 1976 culminated a decade of rapid change in the delivery of legal services to people of moderate means, a change in which Building Trades unions were deeply involved. Once the Supreme Court had verified the constitutional right of citizens to associate for the purpose of obtaining legal services, some of our unions immediately began testing legal plans.

It was a Building Trades union, the Laborers', who in conjunction with the American Bar Association, set up the first prepaid legal plan in 1971, the open panel Shreveport Plan. Another Laborers' International Union local established in 1973, here in the District of Columbia, the first prepaid plan using fulltime staff lawyers. Local after local established, or seriously considered establishing, its own dues funded plan. In most cases a longer range goal was to convert the plan to employer funding. But until enactment of section 120, this was not practical. That section gave prepaid legal services a tax status similar to that enjoyed by health care plans and other fringe benefits, and enabled labor unions to negotiate with employers for legal service plans as a fringe benefit.

Since 1976, thousands of plans have been established and thousands more are being considered. Since the 1981 extension, the Sheet Metal Workers, a Building Trades union, has established a national trust fund for legal services, which more and more of their locals are joining.

Section 120 works. The plans work. They encourage preventive law, reduce the cost of legal services and make them more readily available. The plans have an impressive variety of form, size and focus. They are individually tailored to the needs of each group's members.

I would like to stress one point that may not have been emphasized in other statements. That is what the meaning would be if Congress permitted section 120 to expire. Over the last eleven years Congress three times has acted in support of legal services as a fringe benefit, first by amending the Taft-Hartley Act, second by enacting section 120, third by extending the section. Now that Congress' earlier actions are having their desired effect, for Congress to let section 120 expire -- and that is what will happen if this Congress does not act -- would be tantamount to rejecting equal access to the legal system as a desirable goal.

Is this judgment too strong? I don't think so. With the assistance of section 120, ten times as many people are now covered by a legal plan as were covered when the section was first enacted in 1976. Costs are stable; revenue loss is minimal; plans are virtually unopposed. Their popularity is soaring. Large plans have recently begun on the assumption that Congress would rely on the wholly positive results of its earlier actions and continue to afford qualified plans fair tax treatment with other statutory fringe benefits. Absent a wholesale revision of the tax code it is difficult to see how Congress could determine to let section 120 expire unless it had determined that preventive law and equal access to legal services were undesirable.

Statement on Behalf of the

Laborers' International Union of North America, AFL-CIO,

Before the

Subcommittee on Taxation and Debt Management,

Senate Finance Committee

Jack Curran,
Legislative Director

March 16, 1984

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SUMMARY OF TESTIMONY

1. The Laborers' International Union of North America, AFL-CIO, strongly supports S.2080.

2. The Laborers' Union has pioneered in establishing legal service plans. Together with the American Bar Association we initiated the first modern legal service plan in 1971. In 1974, well before section 120 was enacted, we established the first employer-funded plan. Our Union remains committed to the mutual assistance of its members through prepaid legal service plans.

3. Legal service plans benefit working Americans who are least able to pay for legal assistance and least likely to have an established relationship with an attorney, at affordable prices.

4. Unlike some other fringe benefits, legal service plans require a group in order to work. It is, therefore, critical that employment groups not be discouraged from establishing legal service plans because of unequal tax treatment. By providing tax treatment roughly equal to that of other statutory fringe benefits, section 120 prevents the tax system from discouraging group plans.

5. Eight years of experience have proven that employer-funded legal service plans deliver high quality legal services at low cost. The record is clear: the plans work and the loss to the Treasury is minimal. Section 120, therefore, should be made permanent.

Mr. Chairman, I am Jack Curran, Legislative Director of the Laborers' International Union of North America, AFL-CIO.

The Laborers' Union strongly supports S.2080, and joins in the testimony of the AFL-CIO and in the statement of President Robert Georgine of the Building and Construction Trades Department, AFL-CIO. I would like to emphasize the reasons why the Laborers' Union is so firmly committed to legal service plans and why section 120 should be made permanent.

The Laborers' Union has been a pioneer in the development of prepaid legal service plans for its members and their families. For the average American citizen, access to legal services has become an increasingly important need. The rise of prepaid legal service plans negotiated between employers and unions has brought legal services to working men and women on an affordable basis. It means that legal representation is no longer the domain of the rich.

The members of our Union can now achieve the affordable resolution of their problems in the area of consumer issues, landlord-tenant problems, domestic relations, automobile-related matters and wills, to name but a few. The enactment of S.2080 will ensure the continued equal access to the justice system for the working men and women of America.

- Together with the American Bar Association we initiated the first modern legal services plan in 1971, the open panel plan in Shreveport, Louisiana. That plan still exists.

- In 1973 our District of Columbia locals started the first plan employing full time staff lawyers.

- In 1974 the Massachusetts Laborers' plan became one of the first employer-paid plans, one of a tiny handful negotiated before section 120 gave such plans equitable tax treatment.

- Where neither employer-funding nor dues-funding was possible, Laborers' locals established group plans offering low cost consultations and fee discounts from carefully selected lawyers. The Mail Handlers of Local 301 in Boston, a local affiliate of the Laborers' Union, were an early example of such a plan.

The Laborers' Union led the effort to amend the Taft-Hartley Act in 1973. We led the effort in 1976 to enact section 120, and remain as firmly committed now to legal service plans as we were then. We knew they would work and we have been proven right.

I would like to emphasize that legal service plans need fair tax treatment because they are group-based. Individual plans are much less efficient than group plans. Because a funding mechanism

is usually available, employment-based groups are the best groups to sponsor legal service plans. But if other fringe benefits, some of which do not really require a group base, receive preferred tax status, then legal service plans that make sense and ought to be established, will not be. Legal service plans are attractive and sensible quite apart from their tax treatment. All they require of the tax system is equal treatment.

Section 120 is far from perfect. Nearly eight years after its enactment there are still no final regulations. We remain hopeful that the final regulations, should they ever be issued, will meet the concerns expressed in response to the proposed regulations.

But in conclusion, we support section 120 because it provides the roughly equal tax treatment with other fringe benefits that all legal service plans need to continue to render affordable legal services to their members.

Senator PACKWOOD. Mr. Ruth?

**STATEMENT OF JOSEPH RUTH, MEMBER, EMPLOYER-PAID LEGAL SERVICES PLAN, WASHINGTON, D.C., ACCOMPANIED BY WILLIAM A. BOLGER, EXECUTIVE DIRECTOR, NATIONAL RESOURCE CENTER FOR CONSUMERS OF LEGAL SERVICES, WASHINGTON, D.C.**

Mr. RUTH. Well, Mr. Chairman, I am Joseph Ruth. I live at 1449 S Street, Northwest, Washington, D.C. I was asked to appear today as a sort of representative of millions of Americans who are covered by the legal service plan.

My own case was rather unusual, but I think it illustrates just how valuable these service plans can be. About 8 years before my mother died—that would have been maybe 1970—my wife and my children gave up our place in southwest Washington, and we came to live with my mother because she was elderly and more or less she was unable to care for the home.

So my wife and my family and I moved in with my mother. Some years later, she found out that she had cancer. She was more or less beginning to get worse. She was unable to keep up the place and, as I said, we moved with her.

We found out that she had cancer. She grew worse in 1978. Well, 2 years later she passed, and before possibly that she found out, she more or less was very disappointed, because it seemed as though that the children had neglected her, and she was beginning to tell me that she was more appreciative of my family and I

coming to stay with her, to take care of her, because of the condition that she was going through.

So, before I pour gratitude, she told me that the only thing that she had was the house, and she more or less thought that she would leave it to my family.

So, she called the children together, which was my brothers and sisters, and told them that she was going to leave the house to my family in appreciation for what we've done for her. A few months after that my mother passed.

Well, after the funeral my brother came in, and he presented another will, and he said that there was a later will, later than the one that we had, that my mother had left everything to him.

So, we were more or less confused, and we really just didn't know what to do. I called my family and I asked them had my brother come there any time. So, my daughter said no, that she had not seen him since my mother passed or even before that.

I thought it was very strange, because the will that he had, the date on the will, there was no way possible for him to get in the house or to have anyone there whereby she had made another will.

So we more or less got in touch with a few lawyers, and we found out that it was utterly impossible for us to even pay the price that they wanted in order to take our case.

So my wife remembered that she is a member of Local No. 25, so she remembered that the Local No. 25, the union, had lawyers there. We called, and we talked with Mr. Regan, and he more or less consoled us and told us that he would try to do everything that he possibly could do to help us. We told him that the only thing that we had more or less was the house that my mother had left us in the will. This was all that we had.

So he took the case, and he told us that he would do what he could, and we were consoled that Mr. Regan, you know, was helping us in this matter.

We found out later on that when Mr. Regan took the case, he started and he had gotten handwriting experts, and many things that he did, and we were very happy because of that.

I would just like to say, in my closing, that if you were to do away with this bill, I think a lot of things that are unjust would prevail. But because of the constant care that Mr. Regan had—you know, had considered us in this plan, we were so happy that through this we were able to keep our home.

So I would just like to say that to do away with this bill, we hope that you would consider the law that would make this legal service plan for Local No. 25 possible.

Senator PACKWOOD. Mr. Ruth, I cannot tell you how helpful your testimony is. I am delighted that you are here as a witness today, for this reason:

Just as with many other things that people want to get rid of, they will try to find some unique, specific little example and generalize from it. The argument you will hear over and over is, "All these programs do is defend wild-eyed draft-dodging radicals who want to sue the Government over something." Your case is unusual in the sense of what must have been a very heart-wrenching experience. But your case is much more typical of the kinds of things these plans cover and are designed to help people with. Without

this plan, you are right, you might have lost the house, or you would have had an immense mortgage.

I used to practice law, and I understand the frustration that both the lawyer and the client feel. A lawyer has got to make a certain amount of money to keep body and soul together, and if clients can't come up with some of it, you can't afford to take a case. The lawyer is paying out-of-pocket expenses and filing fees, and everything else.

These plans bridge that gap perfectly. Again, I thank you very, very much for coming.

Gentlemen, thank you. I will see you in a few minutes.

We will conclude with Nancy Gist, Richard Scupi, and Ralph Willhelm.

Mr. Willhelm is substituting for Mr. Carlough.

Do you want to go ahead Ms. Gist?

[Mr. Ruth's prepared statement follows:]

Statement of

Joseph Ruth

before the
Subcommittee on Taxation and Debt Management
Senate Finance Committee

March 16, 1984

SUMMARY OF TESTIMONY

1. Through the legal services plan of Local 25 of the Hotel and Restaurant Workers Union I was able to obtain a lawyer and prevent my house from being stolen from me through fraud.

2. Without the plan I would probably have lost the house even if I had won the case, because I would have had to sell the house to pay the lawyer.

3. Legal services plans are a great thing and you should make sure they can continue.

Mr. Chairman, I am Joseph Ruth. I live at 1449 S St., N.W., Washington, D.C. I was asked to appear today as a sort of representative of the 10 to 12 million Americans who are covered by a legal services plan. My own case was rather unusual, but I think it illustrates just how valuable these legal services plans can be.

About eight years before my mother died, that would have been about 1970, my wife and children & I moved in with my elderly mother into her house on S St., the one where we now live, in order to care for her. She was beginning to be unable to keep up the house and it was unsafe for her to live alone. We gave up our own place in Southwest.

Mother got cancer in about 1974 and grew increasingly sick until she died in 1978. For the last two years she required constant care, which was provided solely by me, and by my wife and daughter. Mother was very disappointed that my 4 brothers and 3 sisters had so little contact with her even though most remain in the area. They almost never visited her, especially after she became ill. She told them that she intended to leave the house to me so that we could continue to live there, and she made a will saying so.

Within a few days of her death my brother Luther produced a typewritten will, dated later than the one I had, that left the house to him on the understanding that it should be sold and the proceeds distributed among all her children. I was shocked. The signature looked like hers, but I was sure it was not her genuine will. It was contrary to everything she

had told my wife and me. To our knowledge my brother had not even visited her during the period when the will was made. (He later claimed to have visited her, with the witnesses, while we were all out.) I consulted a couple of lawyers and came away dismayed. They wanted a big deposit before they would do anything, bigger than we could obtain. They explained that contesting a will was expensive. It was hard to prove and would take considerable time. The worst part was that even if we won we probably would have had to sell the house to pay the fee. You see, the house was about all my mother had, and my wife and I are not wealthy. I work in the kitchen at the Capitol Holiday Inn and my wife is a member of Local 25 of the Hotel & Restaurant Workers Union.

That saved us! My wife remembered that they had legal help available and inquired about it. In December 1978 we met with attorney Paul Regan of Robert Ades and Associates. We found that the legal services plan would cover my case and would pay the legal fees. You can imagine how relieved we were. We knew we were right, but were afraid we would lose our place to live anyway.

Once Mr. Regan got started on the case we felt good about it. He was great. He interviewed lots of people, got a handwriting expert, and everything. It took quite a while before the trial, but Mr. Regan always knew just what to do. I thought the others would give up, but they didn't. One brother refused to join in the fraud, but the others did.

It's very hard to explain just how painful it was to

hear my own brothers and sisters lying like they did. It was one of the worst days of my life. It would have been worse if they had gotten away with it. We won the case, and I haven't spoken to most of my siblings in the two years since. No criminal charges were brought against them.

Thanks to the legal services plan of Local 25 and the excellent work of Mr. Paul Regan, we're still in our house, my mother's wishes were followed, and justice was done. Without the plan we probably would have lost the house even if we had fought against the fraud. At the very least we would be paying off a big loan secured by the house.

As I said earlier, I know my case was very unusual, but I know there must be many, many other poeple who would be spared much heartache and money by having a lawyer to represent them. I hope you will continue the law that makes legal service plans like Local 25's possible.

Thank you very much for inviting and listening to me.

**STATEMENT OF NANCY GIST, ESQ., ASSOCIATE GENERAL COUNSEL, MIDWEST MUTUAL INSURANCE CO., AND DIRECTOR, MIDWEST ADMINISTRATORS, INC., DETROIT, MICH.**

Ms. GIST. Thank you, Mr. Chairman.

I am associate general counsel of Midwest Mutual Insurance Co. We have been writing legal insurance policies for 10 years and cover more than 80,000 families nationally.

You have already heard and will hear again about the usage, the high level of client satisfaction, and the costs associated with group legal plans, and about the basic premise which we all accept, that the legal needs of working Americans are going largely unmet.

I want to emphasize two areas briefly: Prevention and productivity.

The main emphases of group legal services plans, as you know, are access and prevention. Access, because most working people generally don't know when they have a legal problem, or how to find the right lawyer, and are concerned that the cost will be prohibitive, so they end up not getting the services that they need, with the result being the potential for and frequently the reality of the kind of injustice that was just described by Mr. Ruth. These plans eliminate those barriers.

In terms of prevention, so many legal problems can be avoided or minimized through timely advice which can make it possible for

plan members to avoid litigation or serious problems that require substantial legal care.

Because court appearances and legal entanglements take away from working time, and because, for instance, credit problems resulting in garnishments also end up costing the employer money, a related issue is productivity.

It has been demonstrated that employers who provide legal services plans can increase productivity and reduce lost time.

A few years ago we were talking with a Fortune-500 manufacturing firm in Arizona about the possibility of instituting a legal services plan. They asked the head of their employee-counseling department to evaluate the program. He did, and recommended legal services as an employee benefit. He found that 30 percent of the problems that employees brought to him were either actually legal problems or had legal problems as their root cause. And of course what we are talking about are problems with creditors, and domestic problems—the kids are in trouble, the aging parent, and that type of thing.

He projected that in terms of increased productivity alone the company could save $30,000 to $90,000 per year, even after paying the premiums for its 12,000 workers. There is also the likelihood of a decrease in claims for health care services, since the stresses of legal entanglements often manifest themselves in physical complaints as well.

Let me mention, in connection with the frequently expressed concerns about cost escalation that Midwest Mutual's premium—our basic premium—for a comprehensive family plan remains the same today as it was 10 years ago. And one of the main reasons for that is that the group bargaining power which we have been able to achieve through these large employer-funded true groups permits us to negotiate with attorneys to keep the attorneys fees low, and in turn we have been able to keep the premium low. We don't expect a major escalation in premiums and in attorneys fees as a result of an increase in the number of legal services plans which are employer-funded.

We are joined in our strong support of S. 2080 by a half dozen other major insurers. The access, the prevention, and the increase in productivity that we have discussed is only going to occur where tax treatment of this benefit is the same as that of other employee benefits. We urge the passage of this legislation for the benefit not only of workers but employers as well, and we appreciate greatly your continuing support.

Senator PACKWOOD. Here is another classic example of where collective bargaining in employer-employee relations provides a worthwhile social service at a cheaper cost than the Government can provide it. You look at the comparative costs of the legal services corporation, which was set up basically to serve the poor. The cases come in on a case-by-case basis, one at a time, you may have a class action suit here and there—but in terms of productivity or cost, or Government management or mismanagement, we can't touch what you and the unions and the employers are able to do collectively. The unions and the employers will more quickly spot abuses in than the Government would ever spot them, never ever find them, and if we did find them we probably wouldn't ferret

them out. You understand what 99 percent of the workers have to have 99 percent of the time and can cover it in a fashion that we just can't match at the Government level.

Yet there are those in the Government who want eliminate these plans.

Mr. Scupi?

[Ms. Gist's prepared statement follows:]

STATEMENT ON S.2060 ON BEHALF OF
MIDWEST MUTUAL INSURANCE COMPANY
AND
MIDWEST ADMINISTRATORS, INC.

by
NANCY GIST, Associate General Counsel

Before The

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
of the
COMMITTEE ON FINANCE
UNITED STATES SENATE

March 16, 1984

Mr. Chairman, my name is Nancy Gist. I am associate general counsel of Midwest Mutual Insurance Company and director of its administrative and consulting subsidiary, Midwest Administrators, Inc. Midwest Mutual has been writing group legal insurance for ten years; Midwest Administrators consults with and provides administrative services to group legal plans and plans in formation. We currently cover over 80,000 families nationwide.

Midwest operates group plans ranging in size from eight to 15,000 members in 35 states, using a variety of funding mechanisms (employer paid; dues funded; voluntary enrollment member paid; cafeteria) with benefits provided through a number of delivery systems (telephone access; closed panel; contracting attorney and indemnity option arrangements). Plan members include police and firefighters, truckers, teachers, state and municipal workers, credit union members, laborers, retirees, office workers and auto workers. Many of these plans offer a broad range of services including advice, will drafting, defense in civil matters, adoptions, representation in consumer and debtor/creditor matters, traffic problems and the sale or purchase of a residence.

Plan sponsors report almost uniform satisfaction of their members with services received, and that without the plan, their members would probably not have sought or obtained help. And we do all of this at premiums ranging from $12 to $125 per family per year.

Midwest Mutual's annual premium for its comprehensive family policy, $103.80, is the same today as it was in 1974. Our experience reflects the trends in legal services plans generally; premiums have remained level or have been decreased, or benefits have been added for the same premium.

Insurers and others planning and operating group legal services plans are acutely aware of the experience in health care, and most have steered clear of the notorious fee-for-service, and even UCR (usual, customary and reasonable) standards in favor of requiring contracting attorneys to accept plan payment as full payment for services provided. In fact, the health care industry has recently begun to adopt payment mechanisms and delivery systems (like Preferred Provider Organizations and Health Maintenance Organizations) which have been widespread in legal services from the beginning.

A critical aspect of minimizing payments to lawyers for services provided is plans' having the bargaining power to get lawyers to agree to a schedule for payments. True groups, usually employer-funded, hold the promise for lawyers of a pool of potential clients from which they may receive a sufficient volume of new business that they are willing to accept a reduced fee. Other factors contributing to lawyers' willingness to accept reduced rates are lawyer advertising and the virtual glut of lawyers, which are creating competition helpful to stabilizing fees. In any case, group legal services plans can play a role in protecting attorneys' fees from the escalation associated with health care fees.

Employer funded legal services plans can increase productivity, reduce lost time and improve worker morale. A Fortune 500 manufacturer, considering the purchase of a group legal services plan from Midwest Mutual, asked the head of its psychological counseling department to evaluate the program. He did, and recommended it as an employee benefit. He said he found that thirty percent of the problems the employees brought to him were actually legal problems, or had legal problems as a root cause. He projected that, in terms of increased productivity alone, the company could save $30,000 to $90,000 per year even after paying the premiums for its 12,000 workers.

Court appearances and other legal entanglements take away from workers' valuable working time. Most of these can be avoided with the timely legal counseling which is available and encouraged through group legal services plans. Those which do get out of hand can be minimized with the prepaid representation such plans provide.

Workers' unattended credit problems and the resulting garnishments mean expense for the employer. Suspension of a worker's license to drive can mean that he or she does not even get to work. These and other legal complications can lead to the loss of trained personnel; they can be forestalled when legal services are readily available to workers.

Besides the cost in time and money, legal difficulties take an emotional toll that affects productivity and safety on the job. Group legal services plans alleviate this burden by guaranteeing the workers have professional protection against the unexpected without financial strain.

Group legal services plans promote efficient use of legal resources by providing plan members with the opportunity to obtain legal advice and assistance sooner rather than later, before rather than after the fact. The real emphases of these programs is on access and prevention. These plans make it possible for members to avoid litigation or serious problems requiring substantial "legal care" by eliminating the barriers to obtaining timely advice. Clearly the costs of having an attorney review a plan member's contract before it is signed are far less than the costs of that attorney representing the member in litigation relating to that contract later. The value of the preventive aspect of group legal services plans cannot be overstated.

Midwest Mutual Insurance Company and Midwest Administrators, Inc. are joined in their strong support of S.2080 by The John Hancock Mutual Life Insurance Company, The Equitable Life Assurance Society of the United States, the Prudential Insurance Company of America, Aetna Life and Casualty Company, Connecticut General Life Insurance Company, Bankers Life and Casualty Company and Bankers Life of Nebraska. These and other companies across the country have monitored the development of group legal insurance for

as many as twelve years, but the temporary nature of the tax exempt status of this benefit has discouraged most from actively entering the market.

Since the first pieces were passed in Texas, North Carolina and California in 1975, the states have continued to enact legislation which would enable insurance companies to write legal insurance policies. Policies can now be filed in all states but one, Maine, where hearings were recently held on enabling legislation. The number of companies nationally filing for and obtaining approval of policies in one or more states has increased 500% from three years ago, yet most will not undertake major marketing efforts which would make group legal services more widely available until the status of IRC Section 120 is clear.

Our years of experience with these plans has made it clear that middle income, working Americans are at once victimized by and left out of our system of justice. They go unrepresented, unadvised and under-protected through the tangle of courts, agencies, ordinances, regulations and statutes which have increasingly complicated our society. They work, buy cars and refrigerators, take vacations, buy and sell homes, pay tuition, borrow money, sign installment contracts, get traffic tickets, and try to make ends meet, too often unaware of their rights, not knowing that these actions will have legal consequences, concerned about the cost of consulting or involving a lawyer, and obtaining representation only at the last minute, if at all. Effective access to the necessary preventive legal services, guidance, and representation can make a difference in the quality of their lives.

Employer funded plans can help make the ideal of equal access to justice, in its many guises, a reality for many Americans, regardless of their economic class. Their immediate legal needs can be met effectively and inexpensively through such plans. Extension of IRC Section 120 through enactment of S.2080 is imperative to these ends.

35-046 O—84——9

**STATEMENT OF RICHARD SCUPI, DIRECTOR, UAW-GM LEGAL SERVICES PLAN AND THE UAW LEGAL SERVICES PLAN—CHRYSLER HOURLY EMPLOYEES, DETROIT, MICH.**

Mr. SCUPI. Mr. Chairman, I am associated with the prepaid legal services programs that UAW has negotiated with General Motors, Chrysler Corp., and American Motors.

The point that I would like to emphasize now in my oral statement is that all of these programs emphasize the HMO model of delivery systems. They have staff attorneys—salaried attorneys—who provide the legal services. The employers are just as strong a proponent as UAW is of this model of delivery systems because of their experience with health care, and I have heard them often say at the trustees meetings that they just wish they could have gotten started this way in the health care area 30 or 40 years ago.

Senator PACKWOOD. I'll bet you also they secretly say, "I wonder if there is some way we can get the lawyers who handle the cases for General Motors and Chrysler to work on some kind of a system like this, when they look at their annual legal fees that they have coming in." [Laughter.]

Mr. SCUPI. The average expenditure of our program currently is about $40 annually for each active employee. Out of this $40, we also fund services to about 200,000 retirees, so that actually the cost is about $30 per active employee.

This cost has increased—I first became associated in 1973 with the laborers programs in this field, and I don't think the cost has increased at all. Now, part of that is for reasons extraneous to the point I am making about HMO model delivery systems. It has to do with the advertising that has sprung up in the legal profession and the number of lawyers that are on the market these days.

But basically, as Ms. Gist has pointed out, the cost has been flat for 10 years of providing legal services, during a time when I think the cost of living has gone up about 60 percent. And I don't see any prospect of that changing.

So, these are a very low-cost form of fringe benefit And because of the built-in cost controls we have in the HMO model of delivery system, I see that continuing for the forseeable future.

This type of delivery system is only possible in a very large group, and I don't think any large group would develop a program like this except for the tax treatment provided that is comparable to what other fringe benefits receive. This is what we call true groups, and I think it is only a true group that could have this type of delivery system. Otherwise, there wouldn't be the necessary concentration to set up an office. And for that reason, we strongly support these plans, strongly support enactment of your bill, S. 2080.

We appreciate your support in 1981 and 1976, and again this year, to continue this tax treatment of these bills.

[Mr. Scupi's prepared statement follows:]

Statement On Behalf of

UAW-GM LEGAL SERVICES PLAN
UAW LEGAL SERVICES PLAN (Chrysler Hourly Employees)
By Richard Scupi, Director

Before The
Subcommittee on Taxation and Debt Management
Senate Finance Committee
United States Senate

March 16, 1984

Mr. Chairman and Members Of The Subcommittee: My name is Richard Scupi. I appear today on behalf of the UAW-GM Legal Services Plan and the UAW Legal Services Plan (U.S. Chrysler Hourly Employees) to testify in strong support of S.2080, a bill to make permanent Section 120 of the Internal Revenue Code.

We all recognize that the judicial system plays a central role in our society. This means that in order for Americans to fully participate in their society, they must have full access to the judicial system. Increasing awareness of this point created significant interest in prepaid legal services as an employment fringe benefit. In 1976, Congress recognized this interest by enacting Section 120 of the Internal Revenue Code for a five-year period.

Enactment of Section 120 was an important breakthrough, as it permitted collective bargaining for prepaid legal services. UAW took this opportunity to establish a model prepaid legal services program on a national basis. In 1978 the UAW Legal Services Plan

(U.S. Chrysler Hourly Employees) received the first 501(c)(20) ruling from the IRS. By late 1978 the UAW Legal Services Plan was operational.

Because the goal of this first program negotiated by UAW was to provide its Participants with high quality legal services in as economical and efficient a manner as possible, the Plan employed a benefit delivery system akin to the HMO model in health care, permitting the maximum degree of control over the cost and quality of the legal services provided by the program. The Plan selects, employs, trains and supervises the salaried full-time attorneys who provide legal services. The Plan organizes and systematizes the practice in the offices out of which these attorneys work. Plan offices have established in areas where a significant concentration of eligible Participants live and work. About 85% of those eligible for benefits under this program receive services from Plan offices.

In areas where there are not a sufficient number of employees and retirees to warrant establishing a Plan law office, a Cooperating Attorney system was developed to provide benefits. The Plan selected and contracted with attorneys in private practice to provide services to Participants referred to them, to bill the Plan and/or client at specified rates for specified services and to provide the Plan with reports as to each case handled. Participants are referred to Cooperating Attorneys after calling on a toll-free number to the Plan's administrative offices in Detroit so that the referral made is for a specified matter in the fee schedule.

Now in its sixth year of operations, the UAW Legal Services Plan (U.S. Chrysler Hourly Employees) has handled about 90,000 cases for Chrysler employees, retirees, and their dependents. The program also served as a model for future collective bargaining. After Congress extended Section 120 for an additional three years in 1981, UAW and General Motors Corporation negotiated a comparable legal services program. In April 1983, the UAW-GM Legal Services Plan became operational. By the time this program completes its first year of operations at the end of this month, about 85,000 cases will have been opened for Plan Participants. The benefit delivery system for the UAW-GM program is essentially the same as that established by the program for Chrysler workers and retirees.

UAW has negotiated additional legal services programs. In October 1983 a program began serving Chrysler salaried employees and retirees who were not covered by the original Chrysler program. In April 1984 a program for some American Motors Corporation employees and retirees will begin to provide benefits. These programs have been modeled upon the GM program to a large extent.

The existence of all of these programs and their ability to establish the delivery system being employed is clearly dependent upon the existence of Section 120 of the Internal Revenue Code. The parties who collectively bargained these legal services programs would not have done so without the tax provisions placing legal services on a par with other, older fringe benefits.

These programs now have law offices in the following States:

| | |
|---|---|
| Michigan | 16 offices |
| Ohio | 12 offices |
| Indiana | 6 offices |
| New York | 5 offices |
| Missouri | 4 offices |
| Wisconsin | 3 offices |
| Georgia | 2 offices |
| Illinois | 2 offices |
| Maryland | 2 offices |
| New Jersey | 2 offices |
| Alabama | 1 office |
| California | 1 office |
| Delaware | 1 office |
| Kansas | 1 office |
| Louisiana | 1 office |
| Massachusetts | 1 office |
| Oklahoma | 1 office |

In many additional States, there are thousands of persons receiving benefits under these programs from Cooperating Attorneys in their communities.

These programs have proven of great value to their Participants. Some illustrative statements received on questionnaires sent out after cases are closed are as follows:

A worker in Buffalo, New York wrote:

> "I feel that this program allows a person to pursue legal remedies to problems that would be financially prohibitive under most circumstances. We are no longer at the mercy of those who can easily afford an attorney!"

A Tennessess worker wrote:

> "I think UAW and GM did a wonderful thing when they set up this Legal Services because some of us are just not able to pay what the attorneys charge today. We have used this program twice and it has saved us money, and provided complete information and assistance."

A Michigan retiree wrote:

> "I believe the UAW-GM Legal Services Plan provides a vital service to retirees, who otherwise would not be able to afford even such a small item as a common will. This Plan is also a Godsend to the total and permanent disabled of General Motors and the UAW.

An Arizona retiree wrote:

> "I had been putting off having a will drafted for months.

> Your notice of legal services came at an opportune time. Thank you very much for this service. I hope it is not needed again, but if it is, I will doubly appreciate it."

An assembly line worker from Illinois wrote:

> "I think this program is a wonderful program for those of us who make too much money to qualify for the poor class and not enough to say we are rich."

A retiree from Florida said:

> "[I think] this is a very good thing for the retirees -- they have to live on a small pension and can't afford the expense."

The cost of these programs is modest indeed. We estimate the annual cost per eligible worker of these programs is currently about $40 -- and this cost also provides the benefit to over 200,000 retired workers and their dependents. For example, the UAW-GM Plan's funding formula provides 3¢ for each straight time hour worked to provide benefits for workers, retirees, workers laid off for one year or less, and the dependents of each group.

Exhibits have been attached to this statement showing the yearly operating costs of the program for Chrysler hourly workers and retirees, and the types of legal problems which were handled during 1983.

While these programs are still relatively new, as is Section 120, we believe they promise much for the future. Prepaid legal services programs for groups such as UAW members carry with them the promise for fulfilling one of the great dreams of our democracy under the rule of law -- to give each citizen not only equal rights but the means to pursue and defend them as vigorously as necessary to see that the equal rights are realized in practice as well as in theory.

In order for these programs to continue, and for others like them to get started, the enactment of S.2080 is required.

UAW LEGAL SERVICES PLAN
(U.S. Chrysler Hourly Employes)

Cumulative Expenditures
As Of September 30, 1983

| | |
|---|---|
| 1978 | $ 1,103,906 |
| 1979 | 3,571,635 |
| 1980 | 3,844,444 |
| 1981 | 3,279,027 |
| 1982 | 3,206,168 |
| 1983 | 2,198,839 |
| | $17,204,021 |

UAW-GM LEGAL SERVICES PLAN
UAW LEGAL SERVICES PLAN (Chrysler Hourly Employees)

| Cases Opened By Problem Type in 1983 | Count | Percent |
|---|---|---|
| Wills | 14695 | 16.23 |
| Probate | 1767 | 1.95 |
| Taxes - Estate, Inheritance | 94 | .10 |
| Civil Commitment | 70 | .07 |
| Guardianship | 724 | .79 |
| Power of Attorney | 629 | .69 |
| Name Change | 464 | .51 |
| Birth Certificate | 175 | .19 |
| Other Matters | 400 | .44 |
| Income Tax | 1239 | 1.36 |
| Business | 830 | .91 |
| Divorce | 8569 | 9.46 |
| Custody, Visitation | 2187 | 2.41 |
| Support, Alimony | 4274 | 4.72 |
| Adoption | 762 | .84 |
| Other Family | 1735 | 1.91 |
| Criminal | 2215 | 2.44 |
| Drunk Driving | 2101 | 2.32 |
| Traffic | 2661 | 2.93 |
| Juvenile | 641 | .70 |
| Social Security - Age | 193 | .21 |
| Social Security - Disability | 1006 | 1.11 |
| Black Lung | 20 | .02 |
| Medicare, Medicaid | 92 | .10 |
| Unemployment Compensation | 228 | .25 |
| Workers' Compensation | 311 | .34 |
| Other Public Benefits | 231 | .25 |
| Pensions | 195 | .21 |
| Employment Agencies | 21 | .02 |
| Other Employment | 639 | .70 |
| Education | 199 | .21 |
| Auto Property | 1392 | 1.53 |
| Auto-Injury | 1160 | 1.28 |
| Malpractice | 476 | .52 |
| Assault, Battery | 300 | .33 |
| Conversion | 153 | .16 |
| Misrepresentation | 25 | .02 |
| Other Tort | 2013 | 2.22 |
| Immigration, Naturalization | 82 | .09 |
| Auto License | 389 | .42 |
| Military, Selective Service | 41 | .04 |
| Other - Federal | 76 | .08 |
| Other - State | 123 | .13 |
| Other - Local | 218 | .24 |
| Purchase of Residence | 3721 | 4.11 |

| | | |
|---|---|---|
| Sale of Residence | 2009 | 2.21 |
| Non-Residential Property | 1325 | 1.46 |
| Landlord - Tenant | 2001 | 2.21 |
| Deeds | 1855 | 2.04 |
| Foreclosure | 974 | 1.07 |
| Taxes on Property | 284 | .31 |
| Home Improvements | 255 | .28 |
| Other Housing | 3076 | 3.39 |
| Collection Action | 2168 | 2.39 |
| Repossession of Client's Goods | 360 | .39 |
| Garnishment | 989 | 1.09 |
| Other Debt | 1416 | 1.56 |
| Possible Bankruptcy | 2708 | 2.99 |
| Credit | 813 | .89 |
| Consumer Complaint | 5294 | 5.84 |
| Insurance | 1840 | 2.03 |
| Utilities | 404 | .44 |
| Other Consumer | 1420 | 1.56 |
| Client as Creditor | 1055 | 1.16 |
| Non-Legal Matter | 440 | .48 |

Senator PACKWOOD. I might tell you, while I would like to make this permanent, the battle at least has gotten easier. When Jack Curran first brought this to my attention we had the opposition of Senator Long, who was then chairman of this committee, we had the opposition of the administration, and we had the opposition of the chairman of the Ways and Means Committee. But we still managed to get it through.

There is a different current flowing now that is actually more dangerous. That is this current about, "We are going to tax all these fringe benefits—we are going to have a flat tax, and everything that is not now taxed is going to be taxed, including half of the social security benefits that are paid for by the employer, and all untaxed fringe benefits." In the last analysis, in my mind that is a very dangerous philosophy. It will jeopardize all of these different fringe benefits that are provided so cheaply and well.

The demand will then come for the Government to provide these same benefits. The Government will provide them badly and expensively. We will try, but we just won't do it as well as you can do it.

I have no other questions.

Mr. Willhelm, could you also meet with us for just a moment when we are done?

This will conclude the hearing. I appreciate it. It is a perfect record.

[Whereupon, at 10:29 a.m., the hearing was concluded.]

[By direction of the chairman the following communications were made a part of the hearing record:]

LEGAL DEPARTMENT
*ALASKA TEAMSTER-EMPLOYER SERVICE CORPORATION*
1200 Airport Heights Drive, Anchorage, Alaska 99504
(907) [illegible] Extension 259

STATEMENT OF THE ALASKA TEAMSTERS

EMPLOYER PREPAID LEGAL SERVICES TRUST

CONCERNING S. 2080,

A BILL TO MAKE PERMANENT TAX PROVISIONS TO ENCOURAGE

EMPLOYERS TO PROVIDE LEGAL SERVICES FOR THEIR EMPLOYEES

BEFORE THE

COMMITTEE ON TAXATION AND DEBT MANAGEMENT

COMMITTEE ON FINANCE, UNITED STATES SENATE

BY

PHIL REECER, ADMINISTRATOR

ALASKA TEAMSTER EMPLOYER PREPAID LEGAL SERVICES TRUST

MARCH 16, 1984

Mr. Chairman, on behalf of the Alaska Teamster-Employer Prepaid Legal Services Trust and myself as Administrator, I urge your support for, and the prompt enactment of S. 2080. This bill would make permanent those provisions of the Internal Revenue Code which have enabled legal service plans to become so successful in the past decade.

Congress initially addressed the tax status of contributions to these plans during the consideration of the Tax Reform Act of 1976. The legislative history of this Act indicates that, "it was appropriate to provide a tax incentive to promote prepaid legal service plans." This action was taken in response to the efforts of a unique coalition comprised of unions, consumer groups, bar associations and insurance companies. The Act excluded from an employees' income the amounts contributed by an employer to a qualified group legal services plan for employees as well as any services received by an employee or any amounts paid to an employee under such a plan as reimbursement for legal services for the employee, his spouse, or his dependents. Included in the Act was a termination date for these provisions of December 31, 1981.

Throughout the late 1970s, the legal service plan concept took root. Congress obviously felt that these provisions were successful enough to warrant their extension and in 1981 a 3-year extension was included in the Economic Recovery Tax Act. This

resulted in a new expiration date of December 31, 1984 for the provision. With that date rapidly approaching, and with the legislative schedule certain to become crowded, it is imperative that timely action be taken to insure the stability and continued existence of these plans.

Since its inception in 1976, the prepaid legal fringe benefit has been a very worthwhile provision of Teamster collective bargaining agreements for our 10,000 members. Unfortunately, this benefit will not survive unless it continues as a tax free benefit to our members and as a tax deductible contribution for our employers.

The benefits which our members derive from this program are substantial. The advance arrangements concerning the choice of an attorney as well as the attorney's fee create an atmosphere in which our members are comfortable and confident in confronting their legal problems. The result is that our members not only contact lawyers more often, but tend to do so at an earlier point in the course of a problem. In the long run, matters are handled at a lower cost and in a fashion which minimizes disputes and litigation. These employees, I believe, are more efficient and productive since they know their legal affairs are going to be dealt with promptly and professionally without undue cost.

The Alaska Teamsters Legal Services Plan has enabled its membership to obtain quality legal service at a low cost. This

is especially important to our members, most of whom are middle income wage earners. As the legislative history of the 1976 Tax Reform Act indicates low income persons have access to publicly supported legal aid services while individuals with higher incomes can generally afford their own legal expenses. The tax provisions which provide for the tax emempt status which currently extend to qualified legal service plans are essential to insuring that middle income wage earners are granted adequate and competent legal counsel.

As I indicated earlier, there is a unique coalition supporting legal service plans. The existence of this coalition is evidence of the fact that we have a successful program which should not be terminated. Proof of this success is demonstrated in the increase of legal service plans. The National Resources Center for Consumers of Legal Services estimates that over 700 plans exist today compared to 75 in 1975. These 700 plans cover approximately 2 million employees and their families. These 2 million employees receive legal assistance for less than $100 annually per capita. This results in a very small revenue loss to the Federal Treasury. For 1983, the Joint Taxation Committee estimated this loss at $25 million.

The provision of legal services to 2 million individuals and their families at a cost of $25 million has to be one of the most

cost effective programs that exist today. It is one which should be continued.

On behalf of Alaska Teamster Employer Prepaid Legal Services Trust, headquartered in Anchorage, I urge the Committee to move quickly on this legislation to assure the tax status of legal service plans. The extension of section 120 of the Internal Revenue Code will ensure that quality legal service will be available to the working men and women of this nation.

35-046 O—84——10

AFSCME

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*Philadelphia, Pa.*

Maynard White
*Houston, Texas*

March 29, 1984

The Honorable Robert Packwood
Chairman
Subcommittee on Taxation and Debt
Management
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Senator Packwood:

On behalf of the American Federation of State, County and Municipal Employees (AFSCME), I want to submit the enclosed statement for the hearing record on S. 2080.

I appreciate your consideration in this matter.

Sincerely,

William B. Welsh
Director of Legislation

WBW:dp

Enclosure

*in the public service*

This statement is submitted on behalf of the American Federation of State, County and Municipal Employees (AFSCME), a labor union representing more than a million public employees nationwide. We appreciate the opportunity to present our views on S. 2080, a bill that would make permanent a tax provision to encourage employers to provide legal services for their employees.

We would like to thank Senator Packwood for introducing this legislation, which would make Section 120 of the Internal Revenue Code permanent. AFSCME believes that this bill would encourage the growth and development of group legal services, and we strongly urge the Committee to give it favorable consideration.

AFSCME has long supported the concept of group legal service plans. Working men and women of low and middle income have long been priced out of the market of obtaining quality legal care. Traditionally, legal aid has only been available to the top and bottom of the economic spectrum in our society. The upper income brackets can afford to hire a private lawyer, while the lowest can obtain help through legal aid offices. America's middle class has been forced to fend for themselves.

However, in 1976, a major step was taken to assure quality legal aid could be available to all Americans. At that time, Section 120 was added to the Internal Revenue Code, authorizing employer contributions to and services provided under qualified group legal service plans not be regarded as taxable income to employees.

Since that time, AFSCME has helped develop group legal service plans in various jurisdictions across the country, including Columbus, Ohio, Philadelphia, Austin, Suffolk County, New York and New York City.

We believe the New York City group legal plan deserves special mention. AFSCME's District Council 37 Municipal Employees Legal Services Plan (MELS) was one of the first and largest employer-funded plans. It has been in operation since 1977. It serves 100,000 city workers, 15,000 retirees and their families. Its members, employees of the City of New York, work in blue collar, white collar and professional jobs. Their salaries range from $9,000 to $30,000, with a majority concentrated in the lower end. The situations where they need legal aid include domestic relations and other family law matters, consumer and debtor matters, and real estate closings.

Nearly 10,000 persons use MELS every year. Full legal services, including representation in court are provided free of charge to the covered person. MELS hires its own staff: 60 lawyers and 90 support staff, made up of paraprofessionals, social workers and clericals.

Where we have them, group legal service plans have proven to be an important benefit for our members. It allows our middle income and working poor membership ready access to competent legal advice, which in many cases will avoid costly litigation down the road.

AFSCME strongly supports the continued growth of group legal service plans and we believe the only avenue for this growth is Section 120 of the Internal Revenue Code.

Section 120 is scheduled to expire on December 21, 1984. If it is not extended, current plans will be jeopardized and the formation of new plans will be put in serious doubt.

Making Section 120 permanent will not, we believe, cause severe damage to the federal budget. The Joint Committee on Taxation has estimated that the tax expenditure associated with Section 120 amounted to only $20 million in 1982. Even with continued growth of the plans, because of the low cost of such plans, the future tax expenditure will be minimal.

Once again, we want to commend you, Mr. Chairman, for your leadership in this area. We strongly support the passage of S. 2080 and urge the Committee's swift consideration.

Thank you for the opportunity to present this statement. We stand ready to provide any additional information or assistance on this matter as the Committee may require.

STATEMENT ON BEHALF OF THE

AMERICAN PREPAID LEGAL SERVICES INSTITUTE

By

Alec M. Schwartz
Executive Director

Before the

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
COMMITTEE ON FINANCE
UNITED STATES SENATE

On the Subject of

S. 2080, QUALIFIED GROUP LEGAL SERVICE PLANS

March 16, 1984

Statement

Mr. Chairman:

My name is Alec M. Schwartz. I am the Executive Director of the American Prepaid Legal Services Institute located in Chicago, Illinois, and I have been involved in the development of prepaid legal service plans since 1973.

The American Prepaid Legal Services Institute is a non-profit membership organization formed in 1976 by the American Bar Association to provide support and assistance to organizations and individuals involved in group and prepaid legal services. At present, our members include some of the largest and most highly developed group legal plans in the nation and represent a cross-section of insurers, administrators, lawyers and consumer groups active in the field.

We would like to express our appreciation to you, Mr. Chairman, for your efforts over the years to introduce legislation which provides the tax incentive needed to make it feasible for employers to make personal legal services available to employees. We wholeheartedly support your most recent bill (S. 2080), which would make permanent §120 of the Internal Revenue Code, and urge that it be passed into law as soon as possible.

After over ten years of development, employer-paid group legal service plans, have demonstrated their effectiveness in providing employees with personal legal services needed to solve problems which disrupt their lives both at home and at work.

Of particular interest is the way these plans can prevent personal and legal catastrophe which can have a profound effect on an employee's ability to work productively. By making legal counseling available conveniently, often

by telephone, employees are encouraged to consult a lawyer at the outset of a potential legal problem. Absent timely legal help, problems which are ignored or "wished away" can end up with the employee in court (rather than on the job).

But group legal plans, which emphasize preventive legal services, bring such help as close as the nearest phone. Statistics from these plans indicate that 60% to 80% of the problems presented by plan members can be resolved by a lawyer either during the initial call or with a few calls or letters to an adverse party. The result: no time or earnings lost from work, no employee services lost to the employer and reduced anxiety for the worker who might otherwise be distracted from doing his or her job well.

Since 1976 when §120 was enacted, the number of people covered by qualified group legal plans has grown from less than 100,000 to over 4 million today. In spite of the high rate of inflation which occurred during this period, the cost to the employer of these plans has remained almost constant, varying between $30 to $120 per employee per year. New techniques have been developed to efficiently deliver high quality legal services to covered employees, over 20% of whom on the average seek legal services provided through plans each year.

Qualified group legal service plans represent a system developed solely in and by the private sector for the benefit of employees, our economy and the society as a whole. We submit that the minimal projected loss in direct tax revenues is surely offset by the effect these plans can have in reducing time lost from work and the resulting loss of taxable wages. In addition, there is evidence which suggests that the preventive legal assistance afforded under these plans may serve to reduce the number of minor disputes which end up in our tax-supported court system.

Our members inform us that the permanence of the present tax treatment of qualified group legal services plans under §120 is crucial both to continuing to make this benefit available to millions of employees who are presently covered and to expanding the availability of these plans to employers who awaiting resolution of this issue before committing themselves on behalf of their employees.

We therefore urge that S. 2080 be enacted without delay.

STATEMENT

of

BANKERS MULTIPLE LINE INSURANCE COMPANY

to

THE SENATE FINANCE COMMITTEE

regarding

S. 2080, a bill to make permanent

Section 120 of the Internal Revenue Code

Hearing Date: March 16, 1984

Bankers Multiple Line Insurance Company (BML) is an Iowa corporation licensed to transact insurance in all 50 states. It is the property and casualty subsidiary of Bankers Life and Casualty Company, one of the nation's largest life and health insurance carriers. BML maintains its executive offices in Chicago, Illinois with its parent company.

Since 1980, BML has been active in the development and marketing of various group and individual legal expense insurance policies. These insurance plans have been sold on a voluntary enrollment basis, primarily through mass marketing techniques such as direct mail. Although Section 120 of the Internal Revenue Code does not directly apply to legal expense insurance plans such as ours, BML is very interested in the continued vitality of employer paid legal plans as a potential market for its products. Additionally, BML views permanent tax-exempt status for employer contributions to, and employee benefits

derived from, legal plans as essential to continued consumer awareness of prepaid legal services and legal expense insurance as a means of economical access to the legal system.

We believe the growth of prepaid legal services and legal insurance, both as an employee benefit and as an individually purchased product in the open marketplace, will significantly reduce the barriers to access to this country's legal services delivery system. There are over 600,000 lawyers in the country, yet 70% of the adult population have used the services of a lawyer only once or not at all.

Prepaid legal services and legal expense insurance programs seek to eliminate the barriers, real or perceived, between lawyers and those that could benefit from their services. These barriers include fear of cost (often based on lack of knowledge of attorneys' fees), uncertainty of whether a need for legal services exists (often based on lack of knowledge about what constitutes a legal matter or what lawyers do), and lack of information on where to find a lawyer suited to the task.

Prepaid legal plans and legal insurance plans by definition are designed to eliminate or reduce the fear of cost and, in varying degrees depending upon plan structure, to eliminate or reduce the other barriers to access to the legal system.

We believe that making I.R.C. Section 120 permanent will allow the momentum of employer plans to continue, which in turn will have a positive effect in the voluntary marketplace with the eventual result that the great majority of Americans will be participants in a legal plan of one form or another.

George H. Hunter
Senior Vice President

TRUSTEES
ERNEST M. THOMAS, *Chairman*
THOMAS J. KINSEY, *Secretary*
THOMAS J. GOSNELL
DANIEL B. MCDUFFIE
*Plan Administrator*
JEAN M. MITCHELL
*Assistant Plan Administrator*
74

BOSTON TEACHERS UNION
PREPAID LEGAL SERVICES FUND
180 MOUNT VERNON STREET
BOSTON, MASSACHUSETTS 02125
(617) 288-0497

23 March 1984

United States Senate
Committee on Finance
Room SD-219, Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senators:

I am writing in behalf of the 12,069 Boston Public School Teachers and eligible dependents covered by the Boston Teachers Union Prepaid Legal Services Plan, a group legal services plan qualified under Section 120 of the Internal Revenue Code. I write to urge the Senate Finance Committee to recommend approval of S.2080, a bill to make that section of the Code permanent.

The existence of Section 120 has made it possible for our Covered Teachers and dependents to obtain high quality legal services in time to avoid or resolve problems which might have required expensive litigation if action were delayed. This preventive aspect of the prepaid legal plans makes them especially beneficial in terms of controlling costs, reducing court backlogs, and eliminating individual mental and emotional strain.

In our geographic area of service, which includes parts of each of the New England States, our plan offers, as legal plans in general do, a group approach to satisfying a common need. It offers important legal protection to some of those citizens who are neither wealthy enough to afford legal services on their own in many instances where such services are advisable, nor poor enough to qualify for the free legal services available to those who meet various low income criteria.

The drafting of wills, representation during the purchase or sale of permanent residences, and assistance with domestic relations problems are just a few of the covered services which have been so well received by our eligible members. Evidence of the value of this benefit is the fact that, in the 29 months of existence of the Boston Teachers Union Prepaid Legal Services Plan, it has provided attorney's services for more than 1800 legal matters. This benefit certainly deserves equal tax treatment with other statutory fringe benefits and I respectfully ask the Senate Finance Committee to do its part to make it so.

Sincerely,
BOSTON TEACHERS UNION
PREPAID LEGAL SERVICES PLAN

Ernest M. Thomas

Ernest M. Thomas
Chairman, Board of Trustees

EMT/rg

CONNECTICUT LABORERS' LEGAL SERVICES FUND
21 NEW BRITAIN AVENUE
ROCKY HILL, CONNECTICUT 06067

ATTY. RICHARD A. WALSH
ATTY. STEPHEN G. KRISTOFAK, JR.

Telephone
(203) 563-2891

March 2, 1984

Roderick A. DeArment,
Chief Counsel
Committee of Finance
Room SD-217
Dirksen Senate Office Building
Washington, D.C. 20510

SUBJECT OF HEARING: S. 2080 Legal Services
DATE OF HEARING : March 16, 1984
Subcommittee on Taxation and Debt Management

Dear Members of the Subcommittee:

I am the Administrator of the Connecticut Laborers' Legal Services Fund, a jointly trusteed pre-paid legal services plan, which has been covering approximately 4500 Connecticut Laborers and their families since 1976. At the present time we are opening approximately 1800 cases a year, thereby providing much needed legal services to a large number of people, most of whom could not afford the services of a private attorney.

In order to point out to you the value of this benefit, I would like to briefly summarize the results of a questionnaire we sent to our members in 1983. The questionnaire contained a series of questions designed to test the overall attitude of participants who have used the Plan toward the Plan itself, toward the services it provided, and toward its lawyers.

The Plan's positive rating surpassed 90% in every category. This indicates a remarkably high level of satisfaction among those participants who have utilized the Plan.

As Administrator of our Plan I can assure you that our participants value very highly their legal services benefit. Many times I have been told "We don't know what we would have done without you"; "I can't believe we have such a wonderful benefit"; "this is the best of all our fringe benefits"; "why don't other groups get this benefit"; and "without you we wouldn't have known which way to turn".

On behalf of over ten thousand Connecticut residents, I urge you to vote for Senator Packwood's S. 2080, to make permanent a provision to encourage employers to provide legal services for their employees.

Very truly yours,

Richard A. Walsh
Administrator

RAW/jkc

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DENNIS C. LUEBKE
JOHN A. NEAL

March 14, 1984

Mr. Roderick A. DeArment, Chief Counsel
Committee on Finance, Room SD-219
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. DeArment:

Enclosed herewith please find my Testimony.

Very truly yours,

Patrick O. Dunphy, Chairman
Group and Prepaid Legal Services
Committee, State of Wisconsin
Bar Association

POD/jab

Enclosure

CC: Mr. Patrick J. Keating, Chairman
ABA Special Committee on Prepaid
Legal Services
1910 Fisher Building
Detroit, MI 48202

TESTIMONY
OF
PATRICK O. DUNPHY, CHAIRMAN
GROUP AND PREPAID LEGAL SERVICES
COMMITTEE, STATE OF WISCONSIN
BAR ASSOCIATION

STATE OF WISCONSIN )
) SS.
COUNTY OF MILWAUKEE )

Patrick O. Dunphy, being first duly sworn on oath, deposes and states as follows:

1. That he is presently the Chairman of the Group and Prepaid Legal Services Committee for the State Bar of the State of Wisconsin and makes this affidavit on personal knowledge.

2. That as Chairman of the Committee on Group and Prepaid Legal Services, I have become familiar with plans that have been submitted to us for approval for operation in the State of Wisconsin. That these plans offer the potential for high quality legal services at a low cost to the plan members. That the services offered by the plans are important legal services designed to assist in providing preventive legal care to the plan members. That by providing such services the potential for avoiding or resolving problems short of expensive and time consuming litigation is significantly increased.

3. The group and prepaid legal services plans that have been submitted to our committee for review establish that there is an interest in these plans both in the labor and consumer movements, the legal profession and the insurance industry. No opposition has been expressed to any of these legal plans at any time to me or to my knowledge to any members of my committee.

4. Internal Revenue Code Section 120 is set to expire in 1984. Section 120 provides favorable tax treatment for employer-paid plans similar to that of many other statutory fringe benefits. It is my personal belief that this section of the Internal Revenue Code should be made permanent.

5. If Section 120 is made permanent then it will encourage continuation of existing group and prepaid legal services plans and undoubtedly foster additional interest in creating new group and prepaid legal services plan in the future. The general public, members of the labor movement and consumer movements will benefit by having improved access to competent legal services at an affordable cost.

6. Legal services plans deserve equal tax treatment with other statutory fringe benefits.

Patrick O. Dunphy

Subscribed and sworn to before
me this 14th day of March, 1984.

Notary Public
State of Wisconsin
My commission expires 4/28/85.

Statement OF JOEL HYATT
Founder and Senior Partner of Hyatt Legal Services

and

SANDRA DEMENT
Director of Legal Plans - Hyatt Legal Services

Before the Senate Subcommittee on Taxation and Debt Management
of the Committee on Finance

This statement is made on behalf of Hyatt Legal Services, a law partnership which provides legal services under several prepaid legal service plans. Hyatt Legal Services is also the largest general practice law firm in the country, with 120 offices in 18 states and the District of Columbia. Each month our 300 attorneys handle thousands of matters for individual clients, many of whom have never seen an attorney before.

Hyatt Legal Services strongly supports S. 2080, which would make Section 120 a permanent part of the Internal Revenue Code. Section 120 excludes both the employer's contribution and the value of legal services from an employee's taxable income.

The Importance of Section 120

Section 120 has been in effect for eight years, and has encouraged the development of employer-funded legal service plans, provided as a benefit of employment. Without Section 120, all but a handful of the several thousand legal plans now in existence would be terminated. The three major plans that Hyatt Legal Services currently administers would most likely be among those to be terminated.

From a public policy perspective, legal plans are an important development, affecting not only the legal profession, but millions of homeowners, consumers and citizens who are currently covered under these plans. At a different level, these plans are important because they are causing major changes in the structure and availability of legal services to middle income Americans. Prepaid legal plans have resulted in new requirements for consumer accountability and have introduced both cost and quality controls in a profession generally unfamiliar with these concepts. Finally, by making legal help more accessible to average citizens, legal plans are bringing new meaning to the phrase "equal justice under law."

Section 120 is the root from which legal plans grow. Prior to the enactment of Section 120 in 1976, legal plans were the subject of academic debate and theoretical discussion. The

number of legal plans could be counted on one hand. One of these plans was an experiment operating in Berkeley, California. Another was funded by the Ford Foundation. A third was a special project of a Bar Association.

The enactment of Section 120 gave legitimacy to legal plans as a fringe benefit. Section 120 also made it possible for employers to provide legal services as a benefit without having to assume the administrative burden of keeping track and reporting to the Internal Revenue Service on those small amounts paid on behalf of each employee. From the beginning, legal plans were viewed as another kind of social welfare benefit, very similar in nature to health care.

The importance of Section 120 is underscored by the fact that there has been no real development of non-employment plans except for those providing very superficial services. These non-employment arrangements do not begin to provide the kind of comprehensive, family-oriented personal legal services contemplated by most plan sponsors.

Hyatt Legal Services' Experience

Hyatt Legal Services supports Section 120 because of our experience in marketing and administering legal plans. For many years legal plans were viewed as "the fringe of the future." Labor leadership viewed legal services as an attractive membership benefit, but most were hardpressed by the recession and saw their benefit funds squeezed by spiraling health care inflation. For the first time in many years, however, Hyatt Legal Services is seeing a change in the way legal plans are perceived: no longer a fringe of the future, legal plans are now being viewed as "the next benefit we'll try to provide." The interest in legal plans is not limited to labor leadership. In the past six months Hyatt Legal Services received a surprisingly large number of inquiries from employers interested in the possibility of establishing a legal plan for their employees. Hyatt Legal Services determined that the interest was sufficiently strong to warrant marketing efforts aimed for the first time at employers. Accordingly, Hyatt Legal Services last month began offering its legal plans to employers without a unionized workforce. We are providing the Subcommittee with a copy of our new brochure for employers.

Until very recently the only perceived barrier to the development of legal plans was the weakness of the economy. Now, however, some employers have become aware of the risk that Section 120 might not become permanent. Hyatt Legal Services can point to two large employers, one a pharmaceutical

manufacturer and one a telecommunications firm, that have put their active efforts to establish a legal plan for their employees suddenly on "Hold." Without Section 120, Hyatt Legal Services believes these firms will not establish legal plans.

Turning to the legal plans that our firm administers, Hyatt Legal Services currently serves approximately 25,000 families scattered from New York City to Honolulu. Our firm has been involved with legal plans for nearly four years. Approximately 75% of these families are served by Hyatt Legal Services attorneys. Hyatt's contract with the Sheet Metal Workers International Trust provides that Hyatt Legal Services has responsibility for delivering services to covered participants wherever they are located. Because Hyatt Legal Services does not have offices in every community, a flexible three-tier delivery system was developed.

Hyatt Legal Services offices comprise the first tier. Our offices are located in neighborhood shopping malls and other sites that are convenient to clients. In the Chicago metropolitan area, for example, we currently have 14 offices extending from the far western suburb of Schaumberg to the southeastern city of Hammond, Indiana. This year we will be adding six additional offices in Chicago in order to better serve the city. A participant in a legal plan may use any attorney in any office that is convenient to him or her.

Where Hyatt Legal Services does not yet have offices, but where the number of legal plan clients to be served is sufficiently large, Hyatt Legal Services carefully selects one or more law firms to provide services under contract to Hyatt. Hyatt supervises and pays these firms.

Finally, in rural communities or towns with very small groups of plan participants, Hyatt Legal Services operates a fee reimbursement system in which clients are reimbursed for their legal fees.

The legal plan clients that Hyatt serves comprise a small but growing portion of Hyatt's total clients. Assuming Section 120 becomes a permanent part of the Internal Revenue Code, we expect legal plan clients to become a significant proportion of our business, perhaps in excess of 20%. Indeed, in some of our Cleveland area offices, 20% to 25% of our clients are participants in the United Food and Commercial Workers Local 880 and Employers Legal Service Plan.

Hyatt Legal Services is uniquely well suited to serve plan clients:

-- Hyatt's truly nationwide delivery system gives us the capacity to deliver services to groups of employees scattered in worksites across the country;

-- Hyatt Legal Services limits its practice to the kinds of personal legal services most families require -- the kind of legal services most legal plans provide -- and we do not handle labor or business law matters;

-- Hyatt Legal Services has developed an administrative system and a quality and service-oriented training program that ensures that clients in different parts of the country will receive the same high quality services;

-- Hyatt Legal Services plans are very inexpensive, ranging from $4 to $8 per month per employee. Hyatt offers fixed cost plans because Hyatt can control its attorney costs directly;

-- Because Hyatt Legal Services is structured like a "legal HMO," Hyatt's legal plans provide extra value to clients: If a service is covered, it is covered completely from start to finish, no matter how complex or lengthy the proceeding may become; and

-- Hyatt Legal Services is committed to making its services accessible to clients. We use toll-free telephone lines to encourage communication with clients. Our offices are located in neighborhoods convenient to clients and all of our offices maintain evening and Saturday hours so clients need not take time off the job to see an attorney.

A Perspective on Legal Plans and Section 120

When Congress amended the Internal Revenue Code in 1976 to add Section 120, the new provision was viewed as the capstone in a legislative structure that Congress had begun building several years before, first with the amendment of the Taft-Hartley Act to make legal services a subject of collective bargaining, and later in the Employee Retirement Income Security Act of 1974, which expressly identified legal plans as one of the employee welfare benefits that was to be subject to the new law.

The three legislative enactments followed on the heels of a string of Supreme Court decisions holding that groups had a fundamental right, protected by the First Amendment, to establish legal plans for the protection of their members. While the right existed, there was no mechanism to fund the plans.

Congress in its wisdom determined that the free enterprise employee benefit system was best suited to provide that mechanism. Congress therefore set about modifying the labor laws, the employee benefit laws and, finally, the tax laws, in order to achieve that goal.

There were apprehensions, however, on the part of the Department of the Treasury, that the "revenue losses" associated with the exclusion from employee income would be large and would increase rapidly. To accommodate this concern, Congress agreed that Section 120 would be subject to review after five years. In 1981, when the time for review came, Congress was embroiled in other tax legislation and did not have an opportunity to give Section 120 the consideration it required. Instead, Section 120 was extended again, for a period of three years.

That second period is coming to a close. The Department of the Treasury today concedes that its revenue loss fears were greatly exaggerated. By every measure, the plans have succeeded as a means of improving access to needed legal services. They have proven that they can be structured in ways to encourage cost control and enhance the quality of services available to middle-income Americans.

We now have a decade of experience with the three-legged legislative structure that Congress built to encourage the development of legal plans. Certainly it is within Congress' power to dismantle this structure. When seriously examined, however, we cannot believe that Congress means to destroy such an effective, successful and useful institution.

Several years ago a labor leader requested a detailed briefing about legal service plans and what impact they might have in the future. When the briefing was concluded he expressed surprise at what he had learned. He said: "Even if it isn't a collective bargaining priority for our union, maybe we should do it for the good of the country." We recommend that sentiment to you.

Hyatt Legal Services urges your strongest support for Section 120.

1511B

STATEMENT OF

EDWARD J. CARLOUGH, PRESIDENT

INTERNATIONAL ASSOCIATION OF SHEET METAL WORKERS, AFL-CIO

Mr. Chairman and distinguished Senators, my name is Edward J. Carlough. I am the President of the International Association of Sheet Metal Workers, AFL-CIO. I am also Chairman of the Board of Trustees of the International Trust for Legal Services, a 501(c)20 legal services trust fund providing qualified legal services under Section 120 of the Internal Revenue Code.

My statement reflects, therefore, both considerable interest as well as direct experience with the two sections of the Internal Revenue Code that are under review here today.

I want to express my strong support for S.2080, which would make Sections 120 and 501(c)20 a permanent part of the Internal Revenue Code. I would also like to express my thanks to the Chairman for his support over the past ten years for these provisions. Without them, my members would not have a Legal Plan.

Let me briefly describe the International Trust for Legal Services. Our collective bargaining agreement requires participating employers to contribute 15¢ per hour to a 501(c)9 health and welfare fund to pay for both the Legal Plan and a prescription drug plan. Half of the contribution is then transferred to the International Trust for Legal Services, in accordance with the regulations applicable to both Section 501(c)9 and Section 120.

Currently there are 14 local unions participating in the Plan, covering approximately 6,500 families in ten states. The Trust's rules were changed in October to permit locals to cover their retirees as well as their active members, and we are pleased that several locals are now taking advantage of this new rule. By the end of 1984, 11 additional locals are scheduled to join the International Trust, adding another 8,000 families to the Legal Plan. At that time, the International Trust will be providing broad legal service coverage to nearly 15,000 families in 13 states.

The International Trust has a contract with Hyatt Legal Services, a general practice law firm with offices nationwide. Hyatt Legal Services provides legal services directly to two-thirds of our members, and also supervises law firms providing legal services to our members in communities where Hyatt Legal Services does not have offices. Our participating members live in every part of the country, including Connecticut, New York and New Jersey; the Washington, D.C. area; central Ohio, central Michigan and central Illinois; Topeka, Kansas; Louisiana and Texas; southern California, Seattle and Honolulu. We hope within a few years to have members covered in every state.

Coverage under the International Trust is quite comprehensive. It includes wills, family law and real estate matters, the three most frequently needed services. The Plan also provides extensive civil litigation defense coverage when our members are threatened by any kind of lawsuit, as well as criminal coverage if the member is charged with a misdemeanor or a felony. Advice and consultation is unlimited; a member may consult with an attorney in person or by telephone as often as necessary.

The International Trust pays Hyatt Legal Services $7 per member per month to provide all of these services. The rate is fixed for three years.

The International Trust very carefully structured its Legal Plan so that it is convenient for members to use an attorney. We selected Hyatt Legal Services because of their multiple office locations and their evening and Saturday office hours. A member's eligibility for services is verified by telephone, so it is quick, convenient and confidential.

We have also taken steps to encourage members to use the counseling services available to them. We have just begun publishing a monthly newsletter, Focus on Funds, which contains a page devoted to informational articles about the International Trust, as well as legal education. We believe that working men and women are as entitled to an attorney's helpful counsel as the wealthy are. The only practical way to make these services readily available is through a Legal Plan.

Let me demonstrate what I mean by pointing to some statistics I have attached from an annual report prepared by Hyatt Legal Services for the Board of Trustees. I want to highlight two things.

First, our members are using their Legal Plan at a very healthy annualized usage rate of 30.7 percent. Some locals have achieved rates of nearly 40 percent utilization. We think this high utilization is extremely important and speaks well of the Plan. The American Bar Association has reported that 35 percent of the public has a legal problem each year, but only 10 percent ever consult an attorney about these problems. In practical terms, these figures mean that without a Legal Plan, two-thirds of our members who have a legal problem or question

are on their own and must take their chances. We know many of these people lose rights or money that they are legally entitled to. My members' 30.7 percent utilization rate means that every member who needs to see an attorney can do so. That is why I want every member of my international union to be covered under a Legal Plan as soon as possible.

Second, the International Trust's high utilization rates reflect a good mix of preventive law counseling and full legal services. For example, 30 percent of the legal services my members use involve telephone consultations. These consultations are convenient for my members and are the most cost-effective way to ensure that the members talk to an attorney when they need to do so. This type of service is not even available to the average person who needs legal services; only a Legal Plan can provide the necessary administrative structure and make this service available.

We found that more than 50 percent of the cases brought to the Plan involve wills, the sale or purchase of a home and misdemeanor defense representation, primarily for traffic problems.

| | |
|---|---|
| Wills | 21.5% |
| Real Estate Transactions | 16.0% |
| Misdemeanor & Traffic Matters | 13.1% |
| Total | 50.6% |

Based on our experience with the Plans, we have come to the following conclusions:

1. The International Trust's Legal Plan ensures that all of our members who need to see an attorney are able to do so. Without the Plan, statistics suggest that only 10 percent would spend the time, trouble and money necessary to set up an appointment with an attorney. Certain services, such as telephone consultations, are not available at all except through Legal Plans.

2. The International Trust has been able to make legal services available to sheet metal workers far less expensively than if our members were seeking these services as individuals. We worked closely with Hyatt Legal Services to develop stringent cost controls.

3. Because of the structure of the sheet metal industry, we would face strong pressures from sheet metal contractors to drop this Plan if Section 120 were to expire. The average sheet metal worker will often work for as many as five or six different employers in the course of a year. Each sheet metal employer would have to prepare a Statement of Miscellaneous Income (Form 1099) for each employee who worked on a job, however briefly, even though the employer's total contribution might only involve a few dollars.

4. It is my understanding that Congress enacted Section 120 into law as an experiment. The object of the experiment was to determine whether Section 120 would encourage the development of Legal Service Plans, whether Legal Service Plans could deliver high quality legal services at a low cost and whether the Plans would create an unreasonable drain on treasury revenues. Well, Section 120 <u>has</u> encouraged the establishment of Plans, including the International Trust; the International Trust and most other Legal Service Plans do provide a remarkably broad range of services for considerably less than $100 per family per year; and the Treasury Department concedes that the revenue loss is quite minor. We think the experiment has been a remarkable success.

We urge you to make Section 120 a permanent part of the Internal Revenue Code.

1352B

# SHEET METAL WORKERS INTERNATIONAL TRUST
# 1983 UTILIZATION REPORT ON LEGAL SERVICES


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## SECTION I — ELIGIBILITY

This report on utilization of the Sheet Metal Workers' International Trust for Legal Services covers the period from September 1, 1982, the date of commencement of services under the International Trust, through December 31, 1983.

### Eligible Participants

Table I lists all locals that are currently participating in the Sheet Metal Workers International Trust for Legal Services, or that have made arrangements to participate in 1984. There are approximately 3200 currently eligible participants, and 8400 members scheduled to begin receiving services in 1984. These families are scattered through 15 states and the District of Columbia.

In view of the difficult climate under which collective bargaining occurred this past year, the number of new locals that will be participating in the International Trust is quite encouraging. A number of locals signed agreements requiring employer contributions to the International Trust commencing during the second year of their contract. Several have been able to fund the plan out of existing reserves in their local health and welfare funds. A total of 22 locals are already participating in or are committed to future participation in the International Trust. Also, a growing number of locals have members eligible for services through specialty agreements or supplemental income (SASMI) payments.

### Eligibility Procedures

The eligibility verification procedures developed by the International Trust and Hyatt Legal Services are working very smoothly. There appears to be an excellent working relationship between the International Trust, Hyatt Legal Services and those local trust funds that participate in the International Trust.

Almost all of the eligibility calls received by Hyatt Legal Services on their toll-free line are verified against the master eligibility list during that five-minute telephone call. We have maintained a "same day" standard in determining the eligibility of those callers whose names are not on the master eligibility list. In all cases involving an interpretation of the eligibility language of the Plan, Hyatt Legal Services refers these questions to the International Trust.

## SECTION II — COVERED SERVICES

The Plan was designed to cover almost all of the personal legal services that the average family needs. Advice is available on any subject, as often as necessary, and can even be provided over the telephone in appropriate instances.

The Plan provides complete coverage of the following types of matters:

Wills

Document Preparation
Deeds, Notes, Mortgages and Powers of Attorney

Family Matters
Adoptions, Name Changes, Separation, Dissolution or Divorce

Housing Matters
Landlord/Tenant Negotiations, Eviction Defense, Purchase or Sale of a Home

Debt Problems
Dealing with Creditor Harassment, Repossessions, Garnishment, Foreclosure, Bankruptcy, Wage Earner Plans, Defense of Debt Suits

Major Consumer Problems

Civil Litigation Defense

Criminal Defense
Misdemeanors including Drunk Driving Problems, Juvenile Court Representation, Expungement of Criminal Record, Felony Defense

Tax Return Preparation by H & R Block

Reduced Fees on Contingent Fee Cases
Includes Probate, Personal Injury and Workers' Compensation

Eligibility extends to the spouse and dependents as well as the member. Once a case is begun on behalf of an eligible member, it is handled to completion at no cost to the member, even if the member subsequently becomes ineligible.

## SECTION III — SERVICE DELIVERY NETWORK

General Report

Participants in the International Trust are currently using three different delivery systems, all supervised by Hyatt Legal Services. Where Hyatt Legal Services does not have offices in an area, clients are served by a Participating Law Firm. These law firms are selected and supervised by Hyatt Legal Services. Clients in rural areas select their own attorneys and use a claim form to be reimbursed by Hyatt Legal Services.

In 1984, Hyatt Legal Services attorneys will begin serving Sheet Metal families in three major metropolitan areas:

| | |
|---|---|
| Houston | 8 offices |
| Seattle/Tacoma | 6 offices |
| San Francisco/Oakland | 8 offices |

In 1983, the majority of the clients were served by Participating Law Firms. The International Trust is very pleased with the extremely high calibre of law firms that Hyatt has designated as Participating Law Firms.

To become a Participating Law Firm, Hyatt requires:

- A sufficient number of attorneys engaged full-time in the general practice of law;
- Breadth of practice, ensuring that the firm routinely handles all or many of those casetypes which are covered by the International Trust;
- Experienced attorneys;
- Familiarity with prepaid legal service plans or a responsive, service-oriented firm philosophy;
- Excellent references or honors received by the firm or by its attorneys;
- No other clients that might create conflicts of interest; and
- Malpractice insurance coverage.

Participating Law Firms currently provide services in the following areas:

| | | |
|---|---|---|
| California | Riverside, San Bernardino | 2 firms |
| Hawaii | Honolulu and Hilo | 1 firm, 2 offices |
| Illinois | Decatur, Springfield, Champaign-Urbana | 5 firms |
| Michigan | Bay City, Saginaw and Midland | 1 firm each |
| New Jersey-New York | New York City, New Jersey suburbs, Suffolk, Nassau, Orange, Rockland and Westchester Counties | 13 firms (4 in New Jersey), 15 offices |
| | Elmyra, Binghamton, Syracuse and Utica | 1 firm each |
| Texas | El Paso | 1 firm |

Participants in Western Connecticut, Lake Charles, Louisiana and Janesville, Wisconsin are served by attorneys selected by the member. Participants are reimbursed for their attorney fees.

The Reimbursement Fee Schedule

The reimbursement schedule used by Hyatt has proven to be well designed in comparison with actual attorney charges. The International Trust's goal is a reimbursement schedule with fees set so that seven out of every ten attorneys' bills will be at or less than the scheduled amounts. It is the participant, however, who is in control of the fee charged by the attorney. Hyatt Legal Services encourages participants to inquire about the fees they will be charged, and to do some comparison shopping among law firms if they are not satisfied with the fee they have been quoted.

Hyatt Legal Services has reported that, after a year of closed cases, nearly 75 percent were at or under the scheduled amount. Several of the excess charges were in the criminal area, which is more susceptible to fee gouging by attorneys. The International Trust is satisfied that the amounts currently in the reimbursement schedule are properly set. Hyatt Legal Services will continue to monitor the situation.

## SECTION IV — PLAN USAGE

### Usage of the Plan by Local Union

Table II provides a summary of plan usage by local union. It includes information about the number of months each local has participated in the International Trust, and the average number of persons eligible to participate in the International Trust per month. Nearly 750 cases have been initiated by members. A total of 451 cases has been completed, and 298 cases are pending. The last column projects the proportion of members who have used or can be expected to use the International Trust during each local's first full year in the Trust, if usage continues at the present rate. For example, if members of Local 28 continue to use legal services at the current rate, roughly one-third of the members will have used a lawyer by the end of the first year.

The rate of usage thus far is quite good. Generally, a usage rate in excess of 10 percent is good. A usage rate between 15 percent to 20 percent is quite good. Only two locals (one in rural Louisiana and one in Honolulu) are below 15 percent. The reminder letters recently mailed to members in these areas should improve utilization. The rest of the locals have usage rates between 20 percent and 35 percent. This high usage demonstrates that legal services are valued highly by the members, that the International Trust is being extremely well received and that the Hyatt delivery system is working well. Currently, the ratio of open to closed cases is still somewhat high, primarily because most participating locals are still in the early months of participation, and it often takes many months for legal matters to be completed.

### Casetype Report

Table III describes the number and type of legal problems handled for eligible participants. It also shows the type of service provided: telephone consultation, office consultation or full representation. Note that the use of telephone and office consultations has been extensive, comprising fully 40 percent of the cases closed. This figure is very significant. It means that participants are using the plan for counselling, legal information and preventive law purposes, and that the high rates of usage shown in Table II do not mean that plan services are being abused.



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## SECTION V — EXHIBITS

SHEET METAL WORKERS INTERNATIONAL TRUST
TABLE I - PARTICIPATING SHEET METAL WORKERS LOCALS
Through December 31, 1983

| Services Begin | Service Area | Local Union | Average Members Eligible |
|---|---|---|---|
| 09/82 | CT-Fairfield Cty | 39 | 176 |
| 11/82 | IL-Decatur Area | 133 | 192 |
| 11/82 | SMWIA-INT | | 84 |
| 12/82 | LA-Lake Charles | 196 | 62 |
| 02/83 | HI-Honolulu | 293 | 376 |
| 03/83 | NY-New York City, Long Island & New Jersey | 28 | 1924 |
| 05/83 | WI-Janesville | 18 | 11 |
| 10/83 | OH-Columbus | 98 | 48 |
| 11/83 | NY-Elmira | 112 | 114 |
| 12/83 | NY-Syracuse | 58 | 139 |
| 12/83 | IL-Champaign/Urbana | 230 | 59 |
| | | Subtotal | 3185 |
| Future | | | Estimated |
| 01/84 | CA-Riverside, San Bernardino | 509 | 350 |
| 01/84 | IL-Springfield | 84 | 400 |
| 05/84 | MI-Grand Rapids | 408 | 150 |
| 05/84 | TX-Houston | 54 | 1400 |
| 08/84 | WA-Seattle | 99 | 1500 |
| 08/84 | WA-Tacoma | 150 | 400 |
| 12/84 | TX-El Paso | 49 | 200 |
| 12/84 | CA-No. California Trust Participants | 104, etc. | 4000 |
| | | Subtotal | 8400 |
| | | TOTAL | 11,585 |

SHEET METAL WORKERS INTERNATIONAL TRUST
TABLE II - USAGE REPORT BY LOCAL UNION
Through December 31, 1983

| LOCAL UNION | NO. OF MONTHS IN PLAN | AVERAGE NO. OF ELIGIBLES | NO. OF CASES CLOSED | NO. OF CASES PENDING | TOTAL NO. OF CASES | PROJECTED RATE OF PLAN USAGE |
|---|---|---|---|---|---|---|
| 39 | 16 | 176 | 47 | 10 | 57 | 24.3 |
| 133 | 14 | 192 | 54 | 34 | 88 | 39.3 |
| INT | 14 | 84 | 12 | 9 | 21 | 21.4 |
| 196 | 13 | 62 | 7 | 3 | 10 | 14.9 |
| 293 | 11 | 376 | 15 | 21 | 36 | 10.4 |
| 28 | 10 | 1924 | 305 | 196 | 501 | 31.2 |
| 18 | 8 | 11 | 0 | 5 | 5 | 68.2 |
| 98 | 3 | 48 | 5 | 2 | 7 | 58.3 |
| 112 | 2 | 114 | 4 | 8 | 12 | 63.1 |
| 230 | 2 | 59 | 2 | 8 | 10 | 101.7 |
| 58 | 1 | 139 | 0 | 2 | 2 | 17.3 |
| TOTAL | | | 451 | 298 | 749 | |

SHEET METAL WORKERS INTERNATIONAL TRUST
TABLE III - REPORT ON CLOSED CASES
Through December 31, 1983

| Casetype | Number of Cases-Telephone Only | Number of Cases-Consultation Only | Number of Cases-Full-Fee Matters | Total | Percent |
|---|---|---|---|---|---|
| Documents: Deeds Notes, Powers, etc. | 3 | 0 | 20 | 23 | 5.1 |
| Wills | 3 | 1 | 93 | 97 | 21.5 |
| Adoption | 0 | 1 | 1 | 2 | .4 |
| Pre-Marital Agreement | 0 | 0 | 1 | 1 | .2 |
| Divorce | 8 | 5 | 13 | 26 | 5.8 |
| Name Change | 0 | 0 | 1 | 1 | .2 |
| Real Estate | 7 | 4 | 61 | 72 | 16.0 |
| Landlord/Tenant | 6 | 1 | 6 | 13 | 2.9 |
| Debt Collection Defense | 3 | 0 | 4 | 7 | 1.6 |
| Bankruptcy | 1 | 1 | 1 | 3 | .7 |
| Consumer Matters | 21 | 5 | 8 | 34 | 7.5 |
| Civil Litigation Defense | 3 | 3 | 9 | 15 | 3.3 |
| Expungement | 0 | 0 | 1 | 1 | .2 |
| Misdemeanor Defense | 8 | 9 | 42 | 59 | 13.1 |
| Felony Defense | 2 | 0 | 6 | 8 | 1.8 |
| Contingent Fee Consultations | 6 | 3 | 0 | 9 | 2.0 |
| Miscellaneous Consultations | 61 | 19 | 0 | 80 | 17.7 |
| | 132 | 52 | 267 | 451 | 100.0 |

Note: This table categorizes each case on the basis of the most extensive service provided. Many full fee cases, however, will also involve telephone and/or office consultations.

THE
# IOWA STATE BAR ASSOCIATION

Brent B. Green, Chairman
Prepaid Legal Services Committee
2600 Ruan Center
Des Moines, Iowa 50309
515-243-6251

March 26, 1984

Mr. Roderick A. DeArment, Chief Counsel
Committee on Finance, Room SD-219
Dirksen Senate Office Building
Washington, D.C. 20510

Re: S. 2080 - Bill to Make Section 120 of Internal Revenue Code Permanent

Dear Mr. DeArment:

On behalf of the Iowa State Bar Association I would like to submit the following brief statement in support of S. 2080.

The Iowa State Bar Association is a voluntary association which enjoys an extremely high percentage of membership of all lawyers licensed to practice in the State of Iowa. The work of the association is conducted by a board of governors and committee chairmen such as myself who perform services without pay.

The committee of which I am chairman has attempted to analyze the need and impact of prepaid legal service plans for the public and attorneys in the State of Iowa. It is our general consensus that there are many members of the public of this state who do not have adequate financial access to attorneys in situations when legal advice is desirable, if not mandatory. It is our belief that this group of Iowans consists mainly of middle-income individuals who have personal legal problems. It is also the committee's determination that there are many attorneys within the State of Iowa who would be willing to provide effective, low cost legal services to these Iowans pursuant to prepaid legal service plans.

The current activity in the prepaid legal service area within the State of Iowa is not as prominent as in some of the more industrialized states, but the committee discerns increased activity in this area within the state and foresees increased adoption of prepaid legal service plans within the state. It is the Iowa Bar Association's position that everything should be done to encourage the creation and implementation of

these plans based upon the reasons stated above.

The Iowa State Bar Association therefore supports the enactment of S. 2080 making Section 120 of the Internal Revenue Code permanent. If you or any members of the Senate Finance Committee have any further questions relative to this statement, please contact the undersigned.

Respectfully submitted,

Brent B. Green

BBG:amp

MAYER, BROWN & PLATT

COUNSELORS AT LAW

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CABLE LEMAYDC

March 15, 1984

By Hand

The Honorable Robert J. Dole
Chairman
Committee on Finance
U. S. Senate
221 Senate Dirksen Office Building
Washington, D. C. 20510

Re: March 16, 1984, Hearing on Senator Baucus' Bill (S. 1809) To Disregard Attribution Between Limited Partners and Its Application to Real Estate Investment Trusts

Dear Mr. Chairman:

This bill is one of the pending approaches to a serious problem for regulated investment companies (RICs). A different approach was taken in section 810 of the "Tax Reform Act of 1984" (H.R. 4170) approved by the Committee on Ways and Means on March 5, 1984, and tentatively approved by this Committee on March 8, 1984. Real estate investment trusts (REITs) face the identical problem and, thus, whatever solution is adopted should apply to REITs as well as to RICs.

Background

The provisions of the Internal Revenue Code which govern REITs and which govern RICs were adopted at different times but for similar purposes. The RIC provisions were intended to permit small investors to pool their investments in securities, obtain the benefits of professional management, and receive the same tax treatment as larger investors who could own their portfolios directly. The REIT provisions were intended to achieve the same benefits for small investors in real estate. Accordingly, Subchapter M of the Code permits entities qualifying as RICs or as REITs generally to distribute their income without incurring an entity level tax.

The tests for qualification of RICs and REITs are similar. Among the tests both must satisfy are (1) a source of income test and (2) an annual income distribution test. In addition, under section 851(a), an investment company cannot qualify as a RIC if it is a personal holding company ("PHC") and, similarly, under section 856(a)(6), a trust or corporation cannot qualify as a REIT if it would be a PHC (assuming for this purpose that the REIT's income is personal holding company income). The PHC limitation was adopted to preclude extending REIT or RIC status to entities that effectively served as holding companies for a few investors, rather than as a means for many investors to diversify their investments.

The effect of the PHC restriction is to deny RIC or REIT status to an entity if more than 50 percent of the entity is actually or constructively owned by five or fewer individuals. See Code section 542(a). For this purpose, pension trusts, private foundations, and certain other organizations are considered to be "individuals".

For purposes of applying the "five or fewer" limitation, the constructive ownership rules of section 544 apply. Among other things, these rules provide that an individual who is a member of a partnership is considered as owning stock owned by other partners. See Section 544(a)(2).

Section 544(a)(2) does not distinguish between active partners and limited partners. In 1979, the Internal Revenue Service issued a private letter ruling to the effect that, in determining whether a company could qualify as a RIC, there would be no aggregation of stock ownership among limited partners in a limited partnership if no close business relationship existed between them. LTR 7951084 (Sept. 21, 1979). In 1982, however, the Service reversed its position in Rev. Rul 82-107, 1982-1 C.B. 103, which held that section 544(a)(2) requires stock ownership of any limited partner to be attributed to all other limited partners in the partnership. Consequently, if any number of persons owning more than 50 percent of an investment company's stock happen to own limited partnership interests

in the same investment partnerships, regardless of whether those partnerships are unrelated to the RIC, an investment company could be disqualified as a RIC.

The same result would clearly obtain in the case of a REIT, since REITs are subject to the same ownership rules, and the problem is greater for REITs because of their popularity as investments for pension trusts which commonly make unrelated limited partnership investments.

Suggested Amendment

S. 1809 and its counterpart in H.R. 4170 address the problem only for RICs and not for REITs. The similarity of compliance problems faced by REITs and RICs and their historic parallel treatment in Subchapter M strongly suggest that the bill should accord REITs similar treatment. This could be achieved by the modifications to S. 1809 suggested in the attachment. Similar modifications would be required in section 810 of H.R. 4170. We would, of course, welcome an opportunity to confer with you or your staff in this regard.

Respectfully,

Jerry L. Oppenheimer

Timothy C. Sherck

Attachment

March 15, 1984

Proposed Amendment to S. 1809 To Extend Its Application to Real Estate Investment Trusts (REITs) as Well as to Regulated Investment Companies (RICs)

At page 2:

(1) In line 4 strike "paragraph" and insert "paragraphs".

(2) In line 22, delete the quotation marks and period at the end of the line and add the following:

"(11) with respect to any taxable year, a real estate investment trust (within the meaning of Section 856(a) but without regard to paragraph (6) thereof) if, at all times during the second half of such taxable year, not more than 50 percent in value of such company's outstanding stock is owned (determined after application of section 544), directly or indirectly, by or for 5 or less individuals, except that in applying section 544(a)(2), the term 'partner' shall not include any limited partner.".

Note: Section 856(a)(5) currently requires that beneficial ownership of a REIT must be held by 100 or more persons. Reg. §1.856-1(d)(2) provides that the determination of beneficial ownership should be made without reference to the attribution rules. Accordingly, the provision of S. 1809 which would require a RIC to have 100 stockholders (as defined in the bill) is unnecessary, since a similar rule presently applies to REITs.

National Association
of Real Estate
Investment Trusts, Inc.

# STATEMENT OF THE NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS FOR THE RECORD OF HEARINGS OF THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT OF THE SENATE FINANCE COMMITTEE REGARDING S. 1809 (March 16, 1984)

The National Association of Real Estate Investment Trusts, Inc. ("NAREIT") has followed with interest S. 1809 and other pending legislation to alleviate a serious technical problem in the federal tax law governing regulated investment companies ("RICs"). Because of the similarity in its tax legislative framework, the real estate investment trust ("REIT") industry confronts the same problem, but within a market place and regulatory environment that differ substantially from those of RICs. In the context of the consideration of S. 1809, we believe it is appropriate to address several comments to the necessity for related legislative action for REITs.

As explained below, it is our belief that S. 1809, if enacted with corresponding amendments to address REITs, would measurably allay the concerns of the REIT industry under present law. It would nevertheless be only a partial solution. NAREIT would emphasize, however, that other pending legislative proposals affecting the RIC industry problem would, if extended to REITs, have consequences that members of the REIT industry view as potentially disastrous. Accordingly, we take this opportunity to set forth the solution proposed by NAREIT and to urge its approval as a modification to S. 1809.

## Background

Congress enacted the RIC and REIT provisions of subchapter M of the Internal Revenue Code ("Code") with similar objectives. Essentially, the provisions are designed to provide mechanisms for small investors to obtain tax and other advantages of securities and real estate portfolios otherwise available only to wealthy investors able to acquire interests directly or through partnerships. In addition to providing portfolio earnings undiminished by federal taxation at the entity level, RICs and REITs give their investors access to large, diversified portfolios under professional management. Furthermore, the investment vehicles are intended to assure the high degree of liquidity that is necessary for the small investor.

1101 Seventeenth Street N.W., Suite 700, Washington, D.C. 20036, (202) 785-8717

The flow-through tax treatment and other benefits are predicated upon compliance with a series of structural and operational tests imposed on the respective entities. Pertinent to the subject legislation are those tests designed to ensure that RICs and REITs are comprised of numerous small investors whose interests are liquid.

By express provision and incorporation of other law, Code section 851(a) mandates that a RIC shall have effectively at least 100 shareholders and shall not have the characteristics of a personal holding company under section 542 of the Code. Similar conditions are imposed for REITs by section 856(a)(5) and (6).

A RIC or REIT will be deemed a personal holding company and thus disqualified from conduit tax status if 50 percent or more of the entity's stock is held by five or fewer individuals at any time during the last six months of the taxable year. For purposes of this test, the attribution or constructive ownership rules of section 544(a) apply, providing in part that a partner in a partnership is treated as owner of any RIC or REIT shares owned by other members of a partnership. In Revenue Ruling 82-107, 1982-1 C.B. 103, the IRS held that this partnership attribution rule applied without qualification in case of limited partners in a syndicated limited partnership.

Senator Baucus introduced S. 1809 principally to overrule Revenue Ruling 82-107 by amending section 542 to provide that, in the case of RICs, the constructive ownership rules for partners shall be construed to exclude limited partners. The amendment would thus remove the threat that RIC shareholders may unknowingly invest in one or more unrelated limited partnerships and cause disqualification of the RIC, with the attendant harsh consequences of full corporate taxation of RIC income including amounts previously distributed and taxed to shareholders.

As Senator Baucus noted in the introductory statement for S. 1809, the Treasury Department acknowledged the anomaly of these circumstances when Assistant Secretary Chapoton wrote that:

> "Treasury believes that the historical purpose of the RIC provision -- to permit small investors to obtain the benefits of investment diversification and professional management through a widely held investment vehicle taxed in a manner comparable to direct ownership of securities -- is not served by denying RIC status to an investment company with a large number of unrelated individual shareholders merely because some of them have passive limited partnership investments in common."

## Other Pending Legislation

In recognition of this problem and others attributable to the personal holding company limitation for RICs, Congresswoman Kennelly proposed a different approach in H.R. 3529, introduced last year. That bill has recently been approved by the Ways and Means Committee as section 810 of the "Tax Reform Act of 1984" (H.R. 4170). We understand that the Senate Finance Committee tentatively approved the same proposal in its March 8, 1984, markup of the proposed deficit-reduction package. This alternative legislation would provide that a RIC found to be a personal holding company will be subject to additional taxes on undistributed RIC income rather than to the sanction of disqualification.

## Application of Pending Legislation to REITs

The REIT and RIC industries obviously share the concern over inadvertent disqualification by operation of the constructive ownership rules with respect to shareholders who happen to invest in an unrelated limited partnership. NAREIT believes that the prospect of such disqualification is perhaps even more anomalous or unwarranted in the REIT context given the explosive growth of real estate limited partnerships that may attract REIT shareholders. As stated previously, however, we believe other problems exist so that S. 1809, if extended to REITs, would provide only partial relief.

Because of the prevalence of joint venture activity in the real estate marketplace that may involve pension plans and other institutional investors that find REITs attractive investments, some REITs may face the risk of disqualification by application of the constructive ownership rules to general partnerships. Moreover, the personal holding company rules generally may cause unneccessary risk of disqualification during the organizational phase of a new REIT. These concerns were raised in the course of consideration of H.R. 3529 and apparently contributed to its approval. NAREIT strongly opposes, however, application to REITs of the approach introduced in H.R. 3529.

NAREIT believes, that without the threat of disqualification for excessive concentration of ownership in the hands of a few shareholders, the REIT will fail to serve its purposes as a widely-held vehicle for small investors who seek income and appreciation while enjoying the benefit of a liquid investment. In the absence of share accumulation restrictions, many present and future REIT shareholders will be seriously harmed.

Given the generous cost recovery provided for real estate under ACRS, removal of the personal holding company limitation will facilitate the "raiding" of REITs by those who would acquire control in order to obtain the real estate assets for syndication or other application in the tax shelter context. These acquisitions may be accomplished by partial or two-tier tender offers whereby many small shareholders will be frozen out at low and perhaps unfair prices.

Even in the absence of acquisition for purposes such as liquidation, large accumulations may disadvantage small shareholders because the marketplace typically discounts the value of a vehicle whose ownership is dominated by a few investors.

It is our understanding that these concerns are not pertinent to the regulated investment company industry for several reasons. The regulatory framework provided by the Investment Company Act of 1940 other law imposes meaningful limitations on the manipulation or transformation of RICs. For example, a diversified RIC may not be transformed into an operating company or used as a vehicle to acquire operating companies without shareholder approval and SEC authorization for deregistration as an investment company. In addition, 40 percent of the board of directors of a RIC must be disinterested persons, and holders of five percent or more of RIC stock are deemed to be "affiliates" subject to various constraints.

Most importantly, the economic and tax attributes of real estate and REIT investment differ substantially from the forces at work in the investment company medium.

Accordingly, NAREIT believes that the REIT and RIC industries must not be analogized so that identical solutions are adopted for relief from the problems caused by the personal holding company limitation. Given the considerations noted above, NAREIT believes a specific REIT amendment is warranted, either as a modification of S. 1809 or in the context of other appropriate legislation. In this connection, we would advise this Subcommittee that NAREIT is preparing to seek introduction of a bill to address numerous areas of concern unique to the REIT tax regime, including the personal holding company limitation for REITs.

REIT Industry Proposal

On behalf of the REIT industry, NAREIT proposes that the technical problems for REITs under the personal holding company limitation imposed by section 856(a)(6) by providing that, for purposes of application to real estate investment trusts:

(1) The attribution of ownership of stock to an individual under section 544(a)(2) (by virtue of direct or indirect ownership of such stock by or for partners of the individual) shall not apply, and

(2) The stock ownership test of section 542(a)(2) shall apply only to taxable years commencing with the first full taxable year following the effective registration of the REIT's shares under the Securities Act of 1933.

NAREIT appreciates the opportunity to raise the concerns of the industry in the context of consideration of S. 1809. We would welcome the further opportunity to consult with the Subcommittee regarding modification of S. 1809 or other legislation to address the problems faced by REITs.

Statement of

William A. Bolger

on behalf of the

National Resource Center for Consumers of Legal Services

before the

Subcommittee on Taxation and Debt Management
Committee on Finance
United States Senate

on the subject of

S.2080 - Taxation of Group Legal Services Plans

March 16, 1984

35-046 O—84——13

SUMMARY OF TESTIMONY

1. Group legal service plans have proven their ability to deliver high quality legal services at low cost. They are especially effective at preventive legal care -- at avoiding or resolving problems without expensive litigation.

2. Group legal service plans are supported by the labor and consumer movements, the legal profession and the insurance industry. There is no opposition to legal plans. Plans are in the best American tradition of pragmatic, voluntary group action to meet common needs.

3. Congress has an unbroken record of supporting legal service plans, most recently in 1981 by extending Internal Revenue Code section 120 for 3 more years. Section 120 provides favorable tax treatment for employer-paid plans -- including tough antidiscrimination rules -- similar to that of other statutory fringe benefits. It is time now to make that section permanent by enacting S.2080.

4. Section 120 has proven its effectiveness in stimulating the growth of legal service plans at minimal cost in foregone revenue. About 10 million people are presently covered by a plan, the largest portion of these in employer-paid plans, yet the 1983 revenue loss was just $25 million, according to a report of the Joint Committee on Taxation.

5. The Coalition to Make Section 120 Permanent is concerned that the section, and the momentum it has helped engender, will be lost while Congress considers ways to control medical costs, reduce the Federal budget deficit and insure that fringe benefits are fair to all employees. If the 98th Congress does not act, if S.2080 does not pass, section 120 will expire.

6. S.2080 should be enacted because legal service plans have shown that they deserve equal tax treatment with other statutory fringe benefits.

STATEMENT

Mr. Chairman, my name is William A. Bolger. I am executive director of the National Resource Center for Consumers of Legal Services. The National Resource Center is a research and education organization working on legal services delivery issues. Our primary focus is on group legal service plans. We were founded in 1972 by consumer and labor groups, and have closely followed legal plan developments for eleven years. Our members include lawyers, insurance companies, benefits administrators and entrepreneurs as well as legal service plans themselves and the labor unions, consumer cooperatives and other associations that sponsor plans. Together with the American Prepaid Legal Service Institute we are coordinating the Coalition to Make Section 120 Permanent. Active participants in the Coalition include the AFL-CIO, most of whose member unions have some members covered by a legal service plan; the American Bar Association; the Laborers' International Union, which pioneered group legal service plans; Midwest Mutual Insurance Company, the insurer with the most experience with legal service plans; and the United Auto Workers, and UAW Legal Services Plan, whose new plan for General Motors employees and their families covers nearly 1.4 million people.

I want here to emphasize to the Committee the broad support that legal service plans have earned from all parties, to assess the impact of IRC section 120 on the development of plans, and to remind the Committee of the temporary nature of section 120 and the need to make it permanent.

The Coalition includes representatives of all the parties to a legal service plan: clients, plan sponsors, insurers and service providers. What about the public at large; what about the country as a whole? Congress has consistently supported legal service plans, and that support has been well-founded.

The Need for Legal Service Plans

A decade ago, evidence was mounting that a sizable proportion of the American population did not have meaningful access to legal services, and that there was reason to question whether "equal justice under law" was more fiction than reality. The subsequent study of legal needs conducted by the American Bar Foundation confirmed that two thirds of the population has needs for legal services that go unmet. Of these, half have either never seen a lawyer, or have seen a lawyer only once in their lives. While better than 35% of the population each year encounter problems that could be solved by a lawyer, only 10 percent actually seek legal assistance. By contrast, an average of 20 percent of the covered employees in a group plan seek legal services each year. These facts indicate that twice as many people obtain legal assistance in resolving everyday legal problems through participation in a group plan.

These employee-users, in the main, are receiving preventive legal services that often make it possible to avoid litigation or serious or protracted remedial services. Thus, group legal plans tend to preserve employee morale and productivity and assist in unblocking our overburdened judicial system.

What is it about legal plans that creates "win-win" situations, where everybody benefits? Basically, it is that transaction costs are reduced when advance arrangements are made on a group basis for providing needed legal services. Advance payment is not as important as advance arrangements that make legal services readily available. These advance arrangements dramatically reduce the time, cost and uncertainty involved in selecting and consulting a lawyer when a legal question arises. Thus people covered by a plan contact a lawyer more often, but at an earlier point in the course of a problem. More people receive legal advice, about more matters, but matters are handled at lower cost and in a way that minimizes disputes and litigation.

Since legal plans are a pragmatic solution to a real problem, it is no surprise that today's plans trace their roots to the early 19th century. Voluntary group action to meet common needs is an American tradition. However, it was only after a series of Supreme Court decisions in the 1960's established "meaningful access to the courts" as a First Amendment right that legal plans really developed. In the final case, United Transportation Union v. Michigan State Bar, 401 U.S. 576 (1971), Justice Black wrote for the Court:

> (T)he principle here involved cannot be limited to the facts of this case. At issue is the basic right to group legal action, a right first asserted in this Court by an association of Negroes seeking the protection of freedoms guaranteed by the Constitution. The common thread running through our decisions... is that collective activity undertaken to obtain meaningful access to the courts is a fundamental right within the protection of the First Amendment. However, that right would be a hollow promise if courts could deny associations of workers or others the means of enabling their members to meet the costs of legal representation.

The Shreveport Plan, jointly sponsored by the Laborers' International Union, the American Bar Association and the Ford Foundation, began the same year -- 1971.

Congressional Support

Congress' record of support for legal service plans goes back ten years, when it determined that legal service plans provided through the private sector are a desirable mechanism for increasing citizen access to the legal system, and that legal service plans are an appropriate addition to the employee compensation system. The Taft-Hartley Act was amended in 1973 to allow the use of collectively bargained trusts to provide legal services. Within a year the first employer-funded collectively bargained legal service plans were established. In 1974, a further step was taken when Congress included legal service plans among the employee welfare benefit plans subject to Title I of the Employee Retirement Income Security Act. ERISA created a regulatory framework that allowed legal service plans the freedom they needed to experiment and to thrive.

Congress also determined, in 1976, that legal service plans would neither develop nor grow without certain changes in the

tax code to put nondiscriminatory legal plans on a favorable tax footing along with other employee fringe benefits. Accordingly, Congress included in the 1976 Tax Reform Act a new section 120 of the Internal Revenue Code. This provision clarifies the tax status of prepaid legal service plans by providing explicitly that:

(a) Employer contributions to qualified prepaid group legal service plans on behalf of an employee do not constitute income to the employee; and

(b) The value of legal services provided under a qualified prepaid group legal service plan does not constitute income to the employee.

At the same time, Congress created Section 501(c)(20) providing for tax-exempt trusts through which legal service plans could operate.

Because of the experimental nature of the plans in the mid-1970's, Congress made section 120 temporary in order to provide an opportunity to reexamine the effect of section 120 on the plans in the light of actual experience. In 1981 Congress extended section 120 for three years, and it now falls on the 98th Congress to make section 120 a permanent part of the Code. The Coalition firmly believes that legal service plans have proven their value beyond all doubt, and that Congress has no reason to reverse the judgments of the last 6 Congresses.

A Profile of Operating Legal Service Plans

Employer-funded legal service plans are the largest category of plans. The National Resource Center and the American Prepaid Institute estimate that of the ten million

people presently covered by a plan, the largest portion are in an employer-paid plan. These plans include both collectively bargained plans and plans funded unilaterally by employers. While the collectively bargained plans range considerably in size, from fewer than 100 people to 1.4 million, the unilateral employer plans are all small. Collectively bargained plans thus account for almost all the employees covered by employer-funded plans. Almost all major international unions, and some independent locals as well, have members covered by collectively bargained plans.

Section 302(c) of the Taft-Hartley Act stipulates that collectively bargained prepaid legal service plans may not be used to sue either the employer or the union, nor may they be used to defend union officials charged with violations of certain federal labor statutes. Most collectively bargained plans are required to be jointly administered by trustees selected by the employer and the union. Legal service plans established unilaterally by employers are treated just like any other employee welfare benefit plans and must meet the reporting disclosure and filing requirements of ERISA.

Numerically, the other important category of employment-related plans are those funded unilaterally by unions. The National Resource Center's clearinghouse documents suggest that up to one million people may be covered by these plans. These plans are not directly affected by section 120 since they are not employer-funded, but they are usually viewed by the unions as experimental plans that they hope to convert

to employer funding in the future. Graphs including the above figures are appended to this statement.

Plans exist in every region and nearly every state in the country. They are most prevalent in major metropolitan areas.

The legal services provided by plans are those most often needed by average citizens, starting with initial legal consultations, advice and routine follow-up, and continuing through routine matters such as wills, divorces, real estate transactions, consumer matters and so on, depending on the level of plan funding. (Where the plans are funded by a union, job-related legal services such as defense of civil suits -- against police or teachers, for example -- are often also included.) Most plans attempt to provide reasonably generous benefits in case the individual is sued in civil court. Some plans provide some coverage in criminal cases. Traffic and misdemeanor matters are more often covered than felonies. Sometimes only the emergency stages (arraignment and bail) of criminal matters are covered. Plans generally tend not to cover matters subject to contingency arrangements, such as personal injury and probate cases. Some plans cover court costs and other litigation expenses. Almost all plans cover both the employee and his family. Coverage for retirees is also frequently provided.

Because of the potential impact of plans on the private bar, there has been considerable interest over the years in the way in which legal services are delivered. Today we have the benefit of over ten years experience with all types of

delivery systems, and it is clear that each system has advantages that make it the system of choice in certain situations.

Although legal service plans fill a real and important need, their cost is very modest. The cost of legal service plans has not changed much over the years. Today a plan that provides unlimited telephone advice and consultation with an attorney, some limited follow-up and reduced fees for additional services costs between $15 and $60 per family per year. A reasonably comprehensive legal service plan costs between $70 and $250 per family per year. Plans tend to provide more limited benefits initially using whatever monies are available, then expand services gradually when more funds are available. It is difficult to imagine the cost of legal service plans rising dramatically. The average person has a real need for legal services that now generally goes unmet -- but those legal needs can be satisfied inexpensively through a legal service plan.

Revenue Loss

In 1983, seven years after they were recognized in the Code, the revenue loss allocable to qualified group legal service plans was just $25 million, according to the Joint Committee on Taxation. I think you'll agree that's not very much, by Federal budgetary standards anyway. A study 4 years ago by the National Resource Center found that the average employer-paid plan cost $87 per year. At a 20% marginal rate of taxation, that's a subsidy of $17.40 per covered family per year. But

even this may be overstating the cost. In 1981 the UAW-Chrysler plan, then the second largest plan and the only truly nationwide prepaid plan, cost just $30 per year. The cost to the Treasury was about $6 per family. Similarly, the huge new UAW-General Motors plan covering 1.4 million people is funded at just 3¢ per hour. That contribution of about $40 per employee per year covers families, retirees and their families, and recently laid off workers as well.

Our Concern

Section 120 is far from perfect. It is overly complex and burdened with restrictions. Nearly eight years after its enactment there are still no final regulations. We remain hopeful that the final regulations, should they ever be issued, will meet the concerns expressed in response to the proposed regulations. While it would be possible for Congress to improve section 120 now, the Coalition is far more concerned with removing the expiration date for the section by enacting S.2080. Between election year distractions, the budget deficit, health care cost control, flexible spending accounts and other fringe benefit issues, the Coalition is concerned that Congress will let section 120 expire inadvertently. We are completely confident that the facts show the value of legal service plans and of section 120, and the wisdom of Congress in enacting it. We are less confident that section 120 can avoid being overlooked in the press of business.

Letting section 120 expire would undo a decade of work

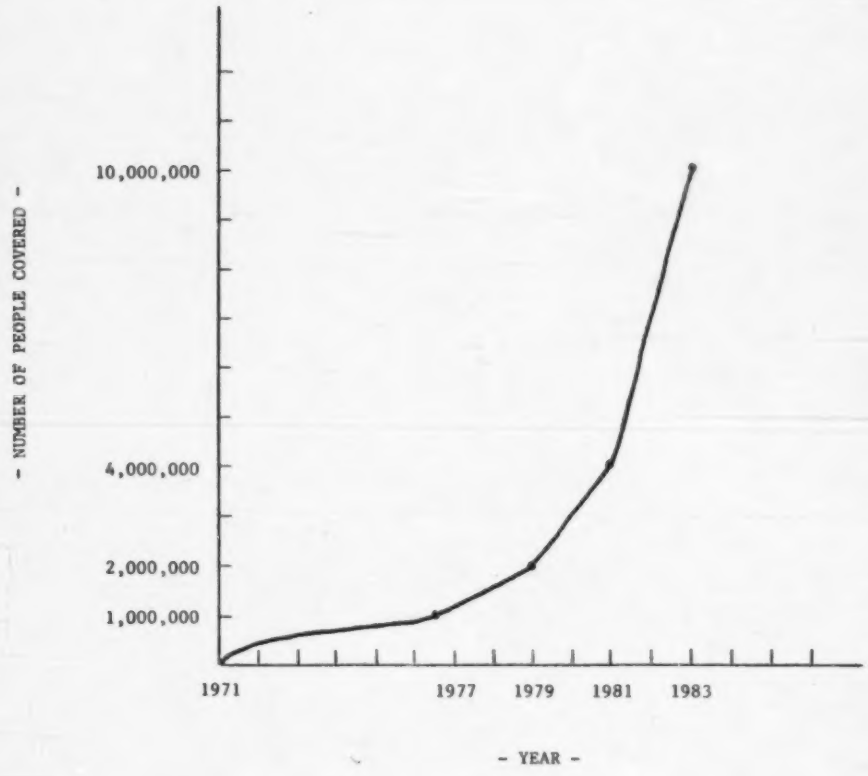
and dash the hopes of consumer, labor and bar association leaders of all political persuasions. Legal service plans have proven they meet a real and important social goal: making legal services, especially preventive services, readily and inexpensively available to working Americans.

Congress must act on S.2080, even to maintain the status quo, or a decade of progress toward equal justice will be jeopardized.

# AGGREGATE LEGAL SERVICE PLAN STATISTICS:

GROWTH - MARKET PENETRATION - LEGAL NEEDS - PLAN TYPES

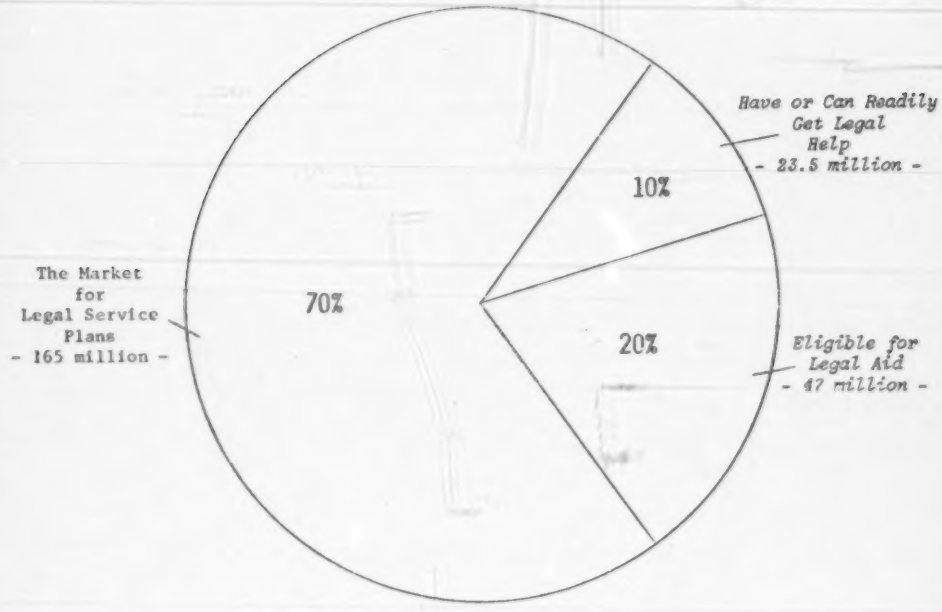
1. GROWTH - NUMBER OF PEOPLE COVERED BY A PLAN IN THE UNITED STATES (INCLUDES FAMILY MEMBERS)



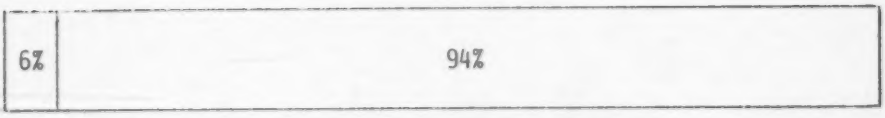

National Resource Center for Consumers of Legal Services
3254 Jones Court, N.W., Washington, D.C. 20007 (202) 338-0714

## 2. MARKET PENETRATION

235.5 MILLION PEOPLE IN THE UNITED STATES



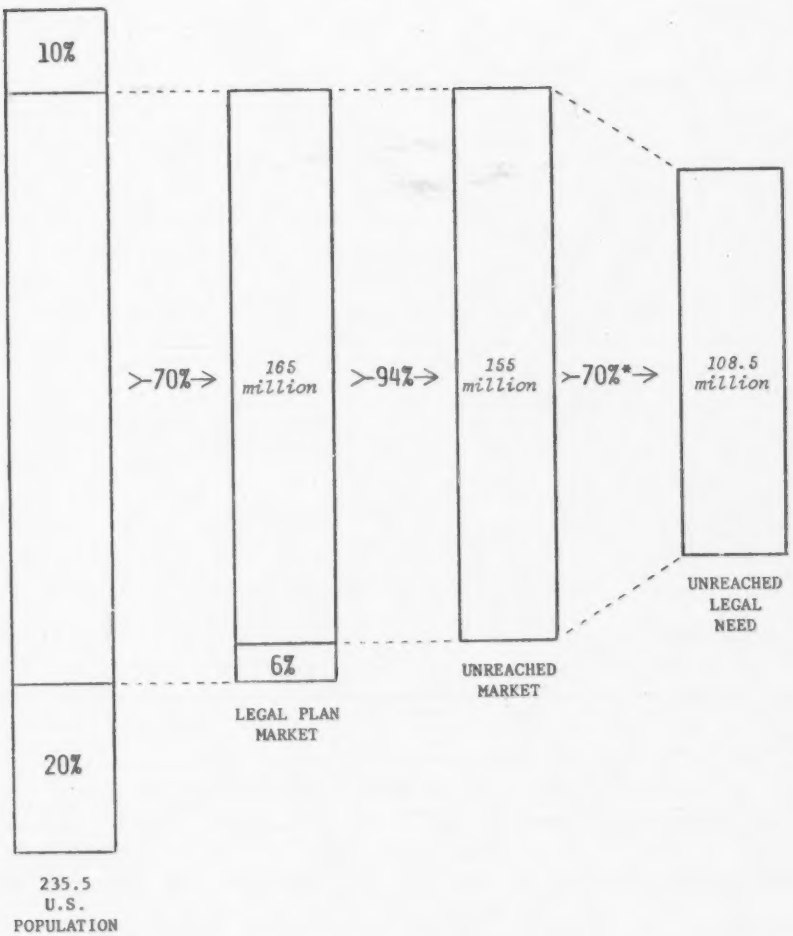

LEGAL SERVICES PLAN MARKET
- 165 million people -




Covered by a Plan
- 10 million -

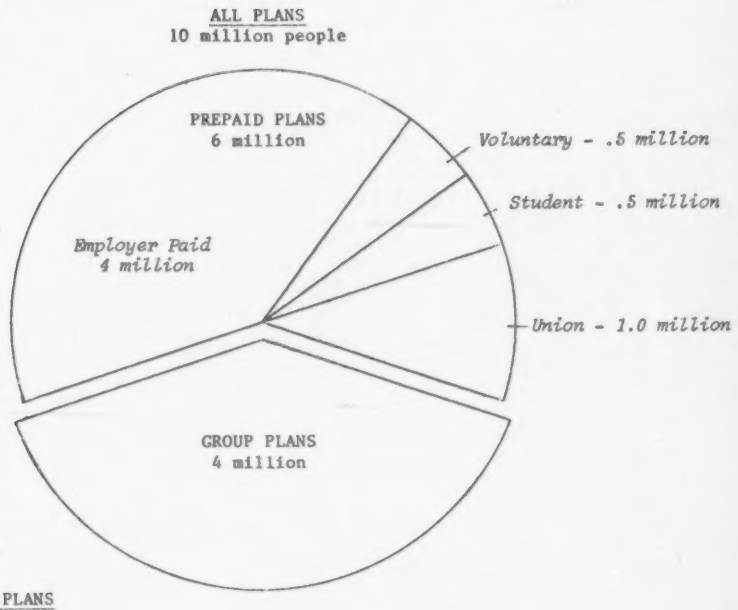
Not Covered by a Plan
- 155 million -

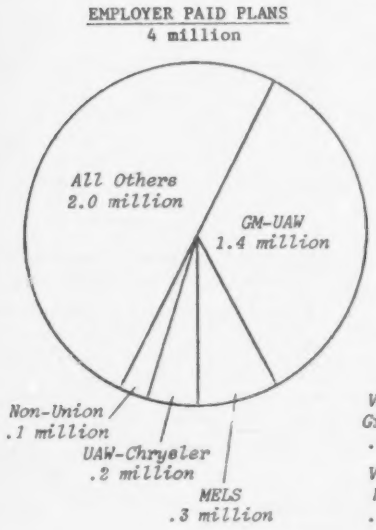
5. LEGAL NEEDS

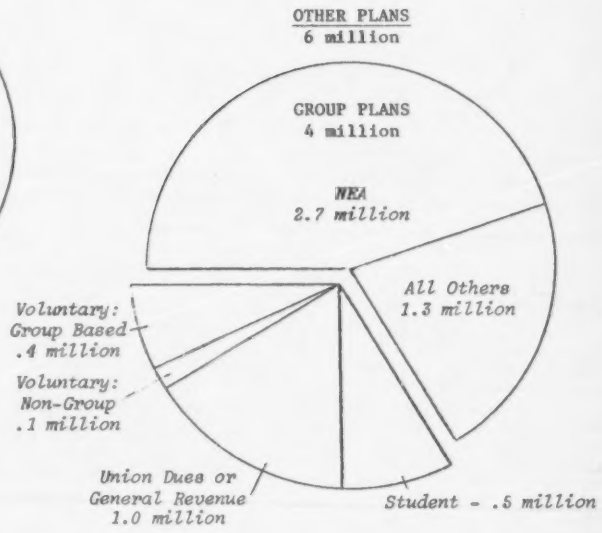



* Per Curran Legal Needs Study

## 4. PLAN TYPES


ALL PLANS
10 million people
PREPAID PLANS
6 million
Employer Paid
4 million
Voluntary - .5 million
Student - .5 million
Union - 1.0 million
GROUP PLANS
4 million


EMPLOYER PAID PLANS
4 million
All Others
2.0 million
GM-UAW
1.4 million
Non-Union
.1 million
UAW-Chrysler
.2 million
MELS
.3 million


OTHER PLANS
6 million
GROUP PLANS
4 million
NEA
2.7 million
All Others
1.3 million
Voluntary:
Group Based
.4 million
Voluntary:
Non-Group
.1 million
Union Dues or
General Revenue
1.0 million
Student - .5 million

PHILADELPHIA FEDERATION OF TEACHERS
LEGAL SERVICES FUND
1616 CHESTNUT STREET ■ PHILADELPHIA, PA 19103 ■ (215) 972-0942

SUNNY RICHMAN
*Chairperson*
*Board of Trustees*

JOHN MALONE
*Fund Administrator*

March 26, 1984

Honorable John Heinz
United States Senator
277 Russell Senate Office Building
Washington, DC 20510

Dear Senator Heinz:

The Trustees of the Philadelphia Federation of Teachers Legal Services Fund urge you not only to support Senator Packwood's bill (S2080) but also to become a cosponsor for that bill. The bill which is intended to make permanent section-120 of the Internal Revenue Code is absolutely essential to the continued existence of our group legal services plan. Without this income tax exclusion, the 18,844 employees of the School District of Philadelphia and their families will be denied quality legal services so necessary to people of modest income who cannot afford these services in any other manner.

We have, since 1978, provided legal services for over 50,000 employees and their families in the City of Philadelphia and its surrounding counties. Thus, with passage of S2080 tens of thousands of Commonwealth citizens will continue to be beneficiaries of a qualified group legal services plan.

Obviously, the Legal Services Fund of the Philadelphia Federation of Teachers is a valuable and necessary service not only to the employees of the School District of Philadelphia but also to the entire community. Therefore, we urge you to support and cosponsor this bill.

Respectfully yours,

Sunny Richman
Chairperson

John J. Malone
Fund Administrator

mjo

cc: Roderick A. De Arment, Cheif Counsel

Statement on Behalf of the

Prudential Insurance Company of America

by

Arthur W. Ericson, F.S.A.

Vice President and Associate Actuary

Submitted to the

Subcommittee on Taxation and Debt Management

of the

Senate Finance Committee

for hearings of March 16, 1984

Statement

My name is Arthur W. Ericson. I am a Vice President and Associate Actuary of the Prudential Insurance Company of America. The majority of my 35 years in the insurance business have been devoted to the underwriting and marketing of group insurance products. For the last ten years, one of my responsibilities has been the development of a group legal services insurance product.

This statement is being submitted in support of S.2080 which would make permanent the tax-free status of qualified group legal services plans. I am convinced that passage of S.2080 will add needed encouragement to the continued development of this product. Most importantly, however, such action will result in considerable value not only for workers and their employers, but also for society. I would like to explain my reasons for this feeling, inspite of the fact that the major group underwriting insurance companies are not involved in most existing plans of legal services.

Let me emphasize that I am referring to those plans which provide benefits for only personal legal services. By personal legal services, I mean services involving such matters as adoptions, residential real estate transactions, domestic relations problems, child support, and consumer protection matters. Nevertheless such plans can fulfill, to a great extent, the legal care needs of the middle class of wage earners in this country. Clearly the wealthy in our society have access to needed legal services and a variety of legal services plans are available for the poor and elderly. In today's world, it is the middle class which could be characterized as "indigent" with respect to legal care.

It must be recognized at the outset that legal services plans as an employee benefit are still a relatively new concept. This is especially so when it is compared with other forms of employee benefits such as group life or group health insurance. Just the absence of a life or death situation sets it apart from the situations which arise in life and health insurance benefits. As a result, the concept itself necessitates education and much support and encouragement at the highest levels.

The concept has experienced a number of difficulties in becoming an accepted employee fringe benefit. A principal barrier for years had been the concerns of organizations such as the American Bar Association. Fortunately, these concerns have been favorably resolved following a number of Supreme Court decisions. As a result of those decisions, as well as amendment to the Taft Hartley Act in 1973, and the favorable tax treatment provided by the Tax Reform Act of 1976 which was renewed in 1981, the development and growth of group legal services plans became a reality. Today, it is estimated that perhaps 6,000,000 people are covered under a variety of group legal services delivery systems.

The vast majority of these people are covered under plans that were established in connection with collective bargaining. Unions have negotiated legal services plans as an employee benefit, just as they had previously bargained for medical care benefits. Indeed, the many similarities between medical care and legal care support the need for group legal services and help explain the entry of major group insurance carriers, such as Prudential, into this market. Consider the following similarities:

- The presence of a legal services program permits an employee to budget for unanticipated legal expenses through a prepaid arrangement very similar to group health insurance.

- Employer sponsored legal services plans allow for spreading the risk of incurring covered legal expenses over the members of the group.

- The availability of both forms of coverage can help avoid catastrophic expenses.

- Use of a group delivery system produces economies of scale that result in "real" dollar savings for members of the group.

- Just as the availability of group health insurance has created access to quality medical care, so can the availability of group legal services coverage improve access to our justice system.

Note from the above that the similarities between health insurance and legal services insurance are in not only the favorable results from underwriting these coverages, but the unfavorable results that may occur when these coverages are not available.

Interestingly enough, the delivery of medical care and legal care have both been the subject of federal and private research, grants, experimental programs, etc. Governmental programs provide access for the needy to both medical care and legal care. The private sector has also chosen to fund a variety of similar programs.

The principal difference between these two forms of insurance is the lack of availability of personal legal services insurance policies. Unlike life, health or automobile insurance, very few insurance companies offer individual legal services insurance policies. This is principally due to the discretionary nature of many

of the services. As a result, the growth of legal services plans on a group marketed and group underwritten basis that would be encouraged by the passage of S.2080 takes on greater significance. Indeed, group legal services plans may represent the only opportunity for many people to budget in advance for legal services and obtain improved access to legal services help.

Benefits for Employees

As I indicated earlier, union interest has spurred the growth of group legal services plans. In such situations, where the value of these plans has been recognized by the unions, many employers have agreed to fund this coverage. It has been our experience, however, that the uncertainty of the tax status of this benefit has impeded employers from extending the coverage to non-bargaining employees.

This is unfortunate because, for all employees, coverage under a legal services plan breaks down the barriers that exist between attorneys and the public due to fear of cost and inability to pay or ignorance of how to get competent legal advice. Rather than waiting until a legal problem blossoms into expensive, unavoidable, unbudgeted litigation, professional legal advice can be sought at the earliest stages of the problem.

Our experience indicates that about 80% of the legal problems or concerns of employees can be resolved after a single conversation with an attorney.

It seems that society becomes more complex every day. As a result, a variety of laws and regulations have been enacted to protect the public in matters such as consumer credit, landlord/tenant disputes or warranties. All too often, the

intended beneficiaries of such legislation are unaware of their rights or responsibilities. In this regard, group legal services plans meet a very important need of a large segment of the public.

By encouraging the development of group legal services plans, this valuable coverage will become available to many employees. Most importantly, however, employees of smaller employers who would not otherwise have the expertise or resources to establish delivery systems comparable to those set up by the larger unions via collective bargaining would now become eligible for such services.

Benefits for Employers

Inclusion of a group legal services plan in an employee fringe benefit package is not only good for employee morale, it makes a lot of sense for employers for other reasons. For example, there is little doubt that the presence of unresolved legal problems can create stress for employees. In dealing with these problems, employees may often seek "on the job" guidance of co-workers, supervisors, or personnel departments. Such stress can also lead to absenteeism and accidents, which further reduce productivity.

In a similar vein, there may well be a correlation between stress and health care expenses. It was recently reported, for example, that two-thirds of office visits to family doctors are prompted by stress related symptoms. Stress costs industry billions of dollars each year. If the presence of group legal services plans can impact upon these expenses just a few percent, by easing the stress on employees who have unresolved legal problems, the savings to industry could be substantial.

Benefits for Society

Beyond the benefits provided for employees and employers, I believe the presence of group legal service plans serve the overall public interest. Clearly, arrangements to assist employees in the areas of adoptions or residential real estate purchases are worthwhile objectives to be encouraged. Furthermore, since the emphasis of these programs is on preventive law, several important benefits may accrue.

1. The objective of equal access to our legal system is well served,

2. There may be reduced pressure on our courts,

3. By solving problems at the earliest stages, catastrophic expenses may be avoided.

These benefits are significant, despite the relatively minor cost of approximately $50 to $120 per member per year.

Insurance Company Interest

Although the role of insurance companies thus far has been limited, we believe the permanence of the tax free status of group legal services plans will encourage the growth and availability of group legal services insurance. As a variety of group legal services programs develop ranging from conventionally insured plans to entrepreneurial programs sponsored by private law firms, we expect that competition will help contain not only the cost of group legal services plans, but also the cost of attorneys' fees in general.

Summary

In summary, group legal services plans provide valuable protection for employees, employers and society at a relatively inexpensive cost. I believe these benefits outweigh the marginal benefits of the slight increase in revenues that would be generated if these plans were taxable. Moreover, the expiration of Section 120 of the Internal Revenue Code would discourage the further growth and benefits of these plans.

PETER J. FINNERTY
Vice President, Public Affairs

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March 28, 1984

Honorable Robert Packwood
Chairman
Subcommittee on Taxation
Finance Committee
SR-259 Russell Senate Office Building
Washington, D. C. 20510

Dear Chairman Packwood:

The Taxation Subcommittee conducted a hearing on March 16, 1984. This letter is in support of two bills considered at that hearing and I respectfully request that it be included in the record of the hearing.

S. 1332, Senator Mitchell's bill to confirm that the full investment tax credit may be claimed on capital construction fund qualified withdrawals would clarify ambiguity and should be passed. We strongly support S. 1332.

S. 1768, also introduced by Senator Mitchell, would provide energy tax credits for equipment used aboard or installed on fishing vessels. We support that bill, but ask that the Subcommittee amend it to also include vessels used in the coastwise, noncontiguous or Great Lakes domestic trades, excluding inland and intracoastal waters. The energy tax credit for equipment should be extended to include fuel efficient propulsion machinery and other equipment, in addition to the items now enumerated in the bill.

A suggested amended version of the bill is enclosed. Such an amendment would create an incentive for construction and reconstruction of fuel efficient ships in U. S. shipyards for transport of U. S. domestic commerce. Fuel conservation by ocean carriers would constitute a significant benefit to U. S. consumers.

This amendment would also provide material assistance to commercial shipyards at a time when their orders are at a record low.

The effectiveness of the amendment in section 46(a)(2)(c) should be extended to December 31, 1986 to allow adequate time for construction of vessels in U. S. shipyards.

SEA-LAND INDUSTRIES, INC. P. O. Box 800, Iselin, New Jersey 08830 : Tel: (201) 632-2241

We are anxious to progress this matter and respond to any questions at your convenience.

Sincerely,

Sea-Land Industries, Inc.

Peter J. Finnerty
Vice President, Public Affairs

PJF:ms
Enclosures

cc: Senator G. J. Mitchell
Peter Friedmann
Lee Rice, Shipbuilders Council of America

S. 1768
AS AMENDED

A Bill to amend the Internal Revenue Code of 1954 to provide energy tax credits for equipment used aboard or installed on fishing vessels [or vessels used in the coastwise, noncontiguous, or Great Lakes domestic trades, excluding inland and intracoastal waters.]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 48 (l) of the Internal Revenue Code of 1954 (relating to property for which businesses may take an energy investment credit) is amended—

(a) by inserting after paragraph (2) (ix) the following new paragraph[s]

"(x) qualified harvesting vessel equipment,"; [and

"(xi) qualified equipment used on vessels engaged in the coastwise, noncontiguous, or Great Lakes domestic trades, excluding inland and intracoastal waters"]

(b) by redesignating paragraph (17) as paragraph [(19)] ;

(c) by inserting after paragraph (16) the following new paragraph[s] :

"(17) Qualified Harvesting Vessel Equipment. - . . .

and

["(18) Qualified Equipment Used on A Vessel Engaged in the coastwise, noncontiguous, or Great Lakes domestic trades, excluding inland and intracoastal waters — The term 'qualified equipment' means equipment (including propulsion equipment) used aboard or installed on a U.S.-flag commercial vessel used in the water-borne carriage of materials, goods or wares, which reduces fuel consumption in the coastwise, noncontiguous, or Great Lakes domestic trades, excluding inland and intracoastal waters, and is:

"(A) a fuel flow meter or fuel management digital microprocessor,
"(B) a hull speed meter,
"(C) a propeller thrust nozzle,
"(D) a variable pitch or two-speed propeller,
"(E) a large-bladed propeller,
"(F) a bow or side thruster,
"(G) a hull treatment,
"(H) a bulbous bow,
"(I) an on-board heat exchanger,
"(J) auxiliary sail equipment, or
"(K) automatic Loran C navigational apparatus,
"(L) propulsion machinery,
"(M) turbo generator equipment,
"(N) exhaust gas boiler equipment,
"(O) fuel blender equipment,
"(P) a high polish propeller.";

and

(d) by adding at the end of the table contained in clause (i) of section 46(a)(2)(C) (relating to the amount of credit) the following new subsection:

[For purposes of this paragraph, a vessel used in the carriage of materials, goods or wares is engaged in the coastwise, noncontiguous, or Great Lakes domestic trades, excluding inland and intracoastal, if it carries such items in movements between ports in any state, or in movements between the contiguous 48 states on the one hand and Alaska, Hawaii, Puerto Rico and the insular territories and possessions of the United States on the other hand, or movements of such items between any of the aforementioned locations, excluding inland and intracoastal waters."]

21. (d) by adding at the end of the table contained in
22. clause (i) of section 46(a)(2)(C) (relating to the amount
23. of credit) the following new subsection[s] :

| | | |
|---|---|---|
| "VII. Qualified Harvesting Vessel Equipment. — | For the period | |
| Property described in section | Beginning | Ending |
| 48(1)(17) . . . . . 10 percent | Jan. 1, 1983 | Dec. 31, 1985.".] |

| | | |
|---|---|---|
| ["IX. Equipment Used on Vessels Engaged in the Coastwise, Noncontiguous, or Great Lakes Domestic Trades. | | |
| Property described in section 48(1)(18) . . . 10 percent | Jan. 1, 1983. | Dec. 31, 1986.".] |